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AFRICAN DEBT CRISIS

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SUBCOMMITTEE ON AFRICAN AFFAIRS

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ON

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AFRICAN DEBT CRISIS

THURSDAY, OCTOBER 24, 1985

U.S. SENATE,
SUBCOMMITTEE ON AFRICAN AFFAIRS OF THE
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The subcommittee met at 9:38 a.m., in room S-116, the Capitol, Hon. Nancy L. Kassebaum (chairman of the subcommittee) presiding.

Present: Senators Kassebaum, Pressler, Sarbanes, and Kerry.

Senator KASSEBAUM. The hearing will come to order.

It is a great pleasure to welcome as our first panelist this morning Lester Brown of Worldwatch Institute.

This hearing is being conducted in order to assess the difficulties that the sub-Saharan African countries are facing in meeting their international debt obligations. We felt that to open this hearing with you, Mr. Brown, was a good way to set the picture of some of the problems that are with us and will continue to be with us in sub-Saharan Africa.

I have very much valued and appreciated the observations you have made and look forward to hearing your testimony.

STATEMENT OF LESTER R. BROWN, WORLDWATCH INSTITUTE

Mr. BROWN. Thank you.

I would like, if possible, to submit the text of the paper we have done at the Worldwatch Institute, Reversing Africa's Decline* as my main input this morning. Then I would like to take just a few minutes to sum up the highlights of that, as a basis for proceeding.

Senator KASSEBAUM. Yes, thank you.

Mr. BROWN. There are few issues being considered in Washington today in my opinion that are as important as what is happening in Africa.

I remember in 1978, the U.S. AID mission in Addis Ababa issued a report which indicated that Ethiopia at that time was losing a billion tons of topsoil per year.

Any agronomist who saw that report would know that Ethiopia was headed for trouble.

Unfortunately, for most people, a billion tons of topsoil is an abstraction and it does not really mean very much.

*Due to cost limitations the committee is unable to print Mr. Brown's submission as part of this transcript, although it is part of the official record of the hearing, it is available for $4 from Worldwatch, 1776 Mass. Ave. N.W., Washington, D.C. 20036.

What we have seen—indeed, I think it was 1 year ago yesterday—was the NBC footage of people starving in Ethiopia. When people saw that footage, then soil erosion suddenly acquired a human dimension. It had a meaning that it did not have before.

That example for Ethiopia encapsulates, I think, what is happening in Africa today. Ethiopia is just a bit further along than the rest of the continent.

As we look at the basic ecological indicators that underpin the African economy, whether forests, soils, grasslands, or the hydrological cycle, we cannot find a single country in Africa that has a positive reading over the past decade for a single basic ecological indicator. All of the indicators are pointing in the same direction, and all are pointing in the wrong direction.

One of the manifestations of the decline in the environmental support systems that underpin the African economy is the decline in per capita grain production. For Africa as a whole, grain production per person peaked in 1967, and has declined nearly a third since then.

This is the first time in the modern period, when we have seen the per capita grain production for an entire continent actually decline.

In 1984, 140 million Africans were fed entirely with grain from abroad.

In 1985, we estimate the number of Africans fed with grain from abroad at 170 million, represents a population that is beginning to approach in size the entire population of North America.

While per capita grain production has been declining, so, too, has per capita income. The average income per person in Africa today is one-fifth less than it was in 1970. Again, for the first time we have a whole continent sliding downhill.

One of the consequences of the decline in per capita grain production has been an enormous growth in food imports and a growth in external debt. In 1973, Africa's grain imports cost $600 million. They now cost more than $5 billion per year.

The shift in the grain balance has been a major factor in increasing the debt in Africa.

I have mentioned thus far four basic indicators: per capita grain production; dependence on grain imports; per capita income; and external debt. Each of those is getting worse, and we do not see anything that is going to turn that situation around.

In looking at per capita grain production, for example, we don't see anything on either the agricultural or the family planning side of the food population equation to arrest that decline that has been underway now for 18 years.

What I think we have not understood very well in Africa is what is happening to the environmental support systems on which the African economy, largely an agrarian economy, depends.

There has been research in the last few years that is beginning to shed some light on what is happening in Africa, and the decline of environmental support systems begins with the loss of trees. With the loss of trees, the nutrient cycle the trees represent—pulling nutrients from deep below the Earth's surface and then dropping them as leaf litter—is being interrupted as the trees are being

lost. Every country in Africa is now losing tree cover, and there are a few countries in which almost all the trees are gone.

Again, there is nothing in sight to reverse that.

Now, as the trees become scarce, then other nutrient cycles are interrupted. Villagers begin to burn cow dung, for example, and crop residues because there are no trees within walking distance any more, and two more nutrient cycles are interrupted.

A study done by an Italian research firm for a middle-sized town in Ethiopia measured something like 29,000 tons of cow dung coming into that city each year on the backs of donkeys. Those nutrients are being siphoned out of the countryside and into the city, and thus depriving the land of its fertility.

Now, as the tree cover is lost and as the land is degraded, then soil erosion begins to accelerate, and the rate of soil loss begins to exceed the rate of new soil formation.

Then the combination of the loss of vegetation and the land degradation begins to alter the hydrological cycle, and the rainfall begins more and more to run off and less is retained by the soil. The soil does not have the absorptive capacity and the plant cover has largely disappeared.

Underground aquifers are no longer recharged in the way they once were, resulting in falling water tables and leaving whole villages without water in various parts of Africa.

The other thing that happens is there is less evaporation to recharge the clouds, and so we think the decline in rainfall is associated with that.

There is a curious relationship, a dependency, between trees and clouds. Trees take water in liquid form from beneath the Earth's surface and convert it into vapor through transpiration, and the vapor forms clouds, and clouds, under the right circumstances, condense that and convert it back into liquid form into rainfall.

So there is this relationship, this dependency between trees and clouds. When you take the trees out of the system, then the cycling does not work as well any more.

Many Third World countries have seen their external debt increase as a result of rising oil prices. As oil prices went up, a lot of countries in the Third World borrowed in order to try to sustain their economic growth.

But, in Africa, in addition to rising oil prices, we have declining rainfall, which is also affecting the external debt situation. I would say to international financial experts who are trying to understand what is happening in Africa economically, that they should start with gaining an understanding with what is happening environmentally. If you do not understand what is happening to the environmental support systems of the African economy, then you will not be able to understand what is happening to the economy itself.

This is a fairly new development. In the past, economists could rely on economic indicators and get a pretty good sense of what was happening. That is no longer the case.

Not only is food affected and the need to import food greatly increased, as I mentioned earlier, but export crops are also reduced, whether it is coffee in East Africa, or cocoa or peanuts in West Africa, or cotton in other countries.

So the decline in rainfall both increases imports and decreases exports at the same time in a sort of double-edged effect.

In looking at the future of Africa—and I should apologize for sort of just hitting the highlights and using a lot of shorthand. I tried simply to lay out the broad situation as a basis for discussion.

In looking ahead, it seems to us at the institute, and both my colleague, Ted Wolf and I have spent some time thinking about this, that any development strategy for Africa that will work has to begin by asking what will it take to restore the environmental support systems that underpin the African economy—the soils, the forests, the grasslands, the hydrological cycle.

Up until recently, the principal criteria for formulating development strategies have been economic. Where the international lending agencies are concerned, such as the World Bank, the principal economic criteria has been the project rate of return.

But we are now moving into a situation where economic criteria are no longer adequate for shaping development strategy.

The new strategy that we think is needed, and the only one that we think will now work in Africa is one that is more people-centered and less capital-centered. This is not to say that we will not need much more capital in Africa. But the things that need to be done to reverse the decline in Africa are grassroots activities, like planting trees, planning families, and building soil conservation terraces, things that can only be done by people organized at the local level.

This is going to require a major shift in lending and development thinking because up until now, the tendency has been to depend on an infusion of capital for most of the larger projects to get development going in Africa.

It is not working very well at this point, and what we have to do is to rethink and go back to the basics.

Up until fairly recently, it has not been necessary for the Congress to worry about such things as ecological carrying capacity because the demands that humans were putting on systems were always below the sustainable yields, the basic biological support systems.

But that obviously is no longer the case in Africa, whether we are looking at grasslands, croplands, or forests. The demands are now excessive.

What we are beginning to do is to consume biological and agronomic capital along with interest. We are consuming the resource base itself.

In looking at the things that need to be done, clearly, Africa has to get moving on family planning. The encouraging thing there is within the past couple of years, many national political leaders in Africa have come out publicly and strongly, recognizing the need for family planning, recognizing that a 3-percent rate of population growth per year—which translates into a twentyfold increase per century—is simply not sustainable.

The environmental support systems in Africa will not support that kind of population growth over an extended period of time.

Now, ironically, while a sense of awareness has been growing among African leaders, the United States is diminishing some of its

support for some of the principal international institutions in the family planning area.

We have cut off all support, for example, to the International Planned Parenthood Federation, which is based in London, and which a year or so ago was in the process of starting to launch family planning programs in a number of African countries. With the cutback in funds, they simply have not been able to do that.

We have, as you know, cut the funding for the U.N. Fund for Population Activities by $10 million, by roughly a quarter of our total contribution. And this is all coming at a time when we should be launching family planning programs in a number of new countries where there is now an interest, a publicly voiced interest. So I think this is one important area where we have to move, and I don't think there is any solution to the debt problem without getting the breaks on population growth.

If we can't do that, then we will never turn the debt situation around.

Another thing we need to be thinking of—and we deal with this in "State of the World—1986," which we are now working on at the institute—is that Africa, over the last 15 years, the period during which grain production has been declining and during which income has been declining, has been militarizing faster than any continent. There is the irony of countries with MIG's and F-15's flying over fields being plowed with oxen.

There is Ethiopia, for example, where many, many groups around the world are passing the hat to collect money to provide food aid to a country that is using 42 percent of its budget for military purposes.

I think these are basic issues that we have to confront and with which we must deal.

Indeed, as I look ahead, it seems to me that the World Bank and the IMF, in addition to getting countries to reduce subsidies on things that are not sustainable, are going to have to begin thinking about basic issues, like militarization, population policy, et cetera, if the situation is going to be turned around. I do not think there is any alternative to dealing with some of these very difficult issues in various international fora.

Madam Chairman, that is a brief summary of some of the points that Ted Wolf and I have covered in our paper on what it is going to take to reverse Africa's decline, and I would be happy to respond to any questions now that either of you may have.

Senator KASSEBAUM. Thank you very much, Mr. Brown.

We appreciate your very thoughtful analysis.

You say that we will have to rethink strategy and that economic criteria alone are not enough. What do you think is the best way to organize the grassroots efforts that you spoke of? Would it be something such as Peace Corps, or can AID handle this? What would be your suggestion?

Mr. BROWN. This is one of the most difficult things to sort out in terms of developing a strategy for Africa.

What is very much needed is the capacity to organize, to organize people at the community level.

That is much more a Peace Corps sort of activity than it is a World Bank activity, for example. What I think we may have to

think about, and we talked with the World Bank about this, is how the Bank, which still needs to put capital into these countries and in larger amounts than at present, is how that capital can be married with an organizational capacity. If reforestation is one of the keys to turning around and arresting the decline of the environmental support systems in Africa, then how do we get those trees planted?

Now, it is going to take some money for seedlings, but that is not the big thing. The big thing is how do you get people organized.

There are countries that have succeeded in this. Maybe we ought to think about bringing in some other Third World countries. South Korea, for example, has achieved a literal greening of that country since 1972, when they launched the National Reforestation Program. They did it at the village level. They now have an area planted in trees, fast-growing pines, on what were once barren hillsides and abandoned land, an area about two-thirds the area planted in rice, which is the national food staple.

So it is a major achievement, and it has been done with very little capital—just some inputs of seedlings, which cost something, but not great sums by international standards.

They have done a number of things with this grassroots effort. They have created an energy resource—firewood at the village level; they have arrested the erosion; they have restored the hydrological cycle; and they have created a new source of timber for construction over the long term.

China is doing some of the same sorts of grassroots things now in the reforestation area, giving local people pieces of land if they will plant trees on them, and the trees become theirs over a long period of time.

We clearly are missing something in Africa, and whether that gap should be filled by a new arm of the World Bank that would be sort of like an International Peace Corps—and there are a lot of young people in the world who would be interested in working in this kind of organization. It would be a chance to put the Europeans, the Japanese, and the North Americans together working for a common cause, on a problem that is going to be one of the most difficult that we in the world are going to be facing over the next few decades.

Senator KASSEBAUM. Well, might one of the problems be, too, just how you work with the country in question, whether it is Zaire, Sudan, or Ethiopia. Doesn't the government itself have to provide more of a structure through which we can work than has been present in many instances?

Do you see this as a problem?

Mr. BROWN. The difficulty in Africa, in a sense, is that the growth in pressure on resources, driven by population, is forcing them to do things that they are not really well prepared to do yet because of their level of development.

It is very difficult to work in many of these countries. I am sure there are people in the room who have worked in Africa with AID or the Peace Corps or the Bank. Even traveling in a country like Ethiopia, I mean, getting from one area to another only a hundred miles away, can take days sometimes, and you have to travel on

foot because there are no roads. Or you can get to them via helicopter, but, obviously, that has its limitations.

So the infrastructure is not there.

In the paper, Ted and I noted that we were searching for some sort of historical analogy for what needs to be done in Africa, and we looked back at the Marshall Plan, for example, which was such a massive international cooperative effort led by the United States. We realized that the Marshall Plan was easy compared with what has to be done in Africa. I mean, basically the skills were there, the institutions were there. The important thing was that the physical plant had to be rebuilt. But, while we knew how to rebuild from the devastation of war in Europe, the ecological devastation plaguing Africa represents a far more intensive effort. This is a much more complex and challenging thing, and it has to be done without the institutions and without many of the skills that are needed.

That is why I think some sort of Peace Corps type of organization is needed, to help get people out at the grassroots level to help decide what kinds of trees to plant and how to organize the plantings, and that sort of thing.

Senator KASSEBAUM. You mentioned something that I thought was very important, and that is the infrastructure. A means of transportation, such as a highway, it seems to me, is very important for export purposes, to go from country to country. This is something that the World Bank could lend, and perhaps has lent, its efforts to.

It almost seems to me that that has to go hand in hand with the other type of very intensive, grassroots effort.

Mr. BROWN. It does.

One of the difficult things in Africa right now is that there are so many immediate needs.

I guess in looking at things like family planning, reforestation, and highway construction, Africa can probably survive without an enormous increase in its highway structure. But it probably cannot survive without an enormous increase in tree planting and family planning.

So, even while we are building the infrastructure, I think we have to give these other activities now the top billing.

Senator KASSEBAUM. Well, I would certainly agree with you.

We tried very hard to lend more support to Africa here in the Senate, but have not been terribly successful. I think everyone recognizes that population growth is a major part of the problem, along with all of the other factors, and they play on each other.

I would like to ask you how much emphasis you would place on donor coordination and multilateral assistance, versus bilateral—although I do not think that necessarily is a key. But I have felt donor coordination is terribly important.

Mr. BROWN. Two or three things come to mind in response to that question. One is that Africa, in contrast to India, for example, is 52 countries or so. So you have 52 governments to deal with.

What we now have is a lot of groups, governments, agencies, and voluntary groups, dealing with many different governments and with no overall sort of coordination.

I think someone needs to take the initiative in orchestrating a response to the situation in Africa. As we look around, it looks to us as though the only institutions that is strong enough to do this is the World Bank.

Now, the World Bank is not ideally suited, because many of the things that need to be done are at the grassroots level, and that is not a strong point in the Bank. That is why I think of the need for a new arm of the Bank or possibly establishing working relationships with the voluntary agencies, which the Bank has generally not done in the past. It has worked only directly with governments.

To begin with, I think there is a need for the Bank, for example, to do some systematic projections for Africa, and not merely economic projections, but to develop some models that incorporate things like trends in deforestation and soil erosion, what is happening to the hydrological cycle, along with population and economic trends, and integrate those into one model. Thus it would be possible for a government, such as in the Sudan or in Nigeria, or wherever, to look ahead and see what the consequences are of continuing along the path they are now on. Unless that is clearly understood, the need for the dramatic initiatives that we see will not be convincing.

If governments are going to shift priorities dramatically, if people are going to change behavioral patterns dramatically, then they have to have a reason for doing it. They have to have information.

This, incidentally, was one of the keys in the reforms in China, a set of projections where they not only projected the economic trends, but the resource trends that underpin them. Then, once they saw what would be happening to cropland per person and even fresh water supplies, much less energy, jobs, and so forth, they saw they had to make some dramatic changes or they would be headed for trouble and risk losing all the gains of the past generation.

So I think there is a need for someone like the Bank to take the intellectual leadership and create the support, the analysis that will provide the support. If we do not have a clear idea of what is happening, there will be a tendency, which is, I think, fairly widespread, to think that what is happening in Africa over the last few years is a drought, and a drought is ending or will end shortly and things will go back to normal and we won't have to worry about Africa again.

But that is not the way we think it is happening. We think we have to dig in for the long haul with some important commitments and some research to underpin those commitments.

Senator KASSEBAUM. I have just one further question.

How do you assess the role of the IMF in trying to bring about a change in some government policies which I think clearly had a negative impact on agricultural growth? As the farmers have had to keep the urban areas supplied with low-cost products, they have simply not been able to grow a sufficient amount.

Mr. BROWN. I have not had access to all the detailed negotiations between the IMF and the various countries in Africa. But I know, as a general matter, where countries have had subsidies on things like gasoline, which were obviously designed to placate the urban

elites and food subsidies that have the same purpose, they have tended to discourage those. I know the World Bank is pressing for a reversal on food price policies away from the ceiling price sort of mentality, toward a support price approach.

So, if farmers are thinking about using fertilizer at planting time, they will know that at harvest time there will be a minimum price that will at least cover the cost of the fertilizer.

I think we need those kinds of policy reforms, and I think the IMF or perhaps the Bank should be the means for bringing about these changes.

I mentioned earlier that I think we have to go beyond things like gasoline subsidies and food price policy and deal with population policy and demilitarization, if we are serious about turning the situation around.

I think a multilateral institution, like the Bank or the Fund, is in a much better position to press on with those kinds of issues than any national government is.

Senator KASSEBAUM. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you, Madam Chairman.

Mr. Brown, do you think the wrong development policies were foisted on the African countries by those outside wishing to help, or do you think the African countries pursued erroneous development policies?

Mr. BROWN. I would split down the middle on that one and simply point out the following. In looking at agriculture, for example, which is a large part of what we are considering, in 1950, there were 250 million people in Africa. Over the centuries, agricultural systems had evolved that were stable and which worked reasonably well. They were fairly drought resistant and included slash and burn agriculture and various rotational farming systems that relied on a combination of trees and crops and so forth.

But then, as population went from 215 million in 1950 to 500 million now, or 550 million, those systems began to break down. The alternative technologies were simply not there, and they had to come quickly. They were not there within Africa and they have not been available for the most part from outside Africa because of the nature of African agriculture. We could not take the wet rice technological successes in Asia, for example, and transplant them to Africa because there is not much wet rice in Africa.

We could not use the technology we have used in corn, for example, except in a few areas of Africa because corn is only one of a half dozen major staples.

African agriculture is highly diversified, and it is largely semiarid. So suitable technologies available from the outside have been limited. We have not yet had an opportunity to develop an alternative to slash and burn cultivation, for example.

So, it is against this backdrop that we look at what both African governments have tried to do and what international aid agencies have tried to do. We find that many things have not worked very well.

It is not as though one had been a smashing success and the other a failure. That is not the case.

But I think it is now widely recognized that the things that had been tried—the World Bank has gone on record and said that things that the Bank has tried have not been working very well, and they pointed out that nor has it for anyone else either—have not been working very well.

So we have to rethink economic development in terms of the ecology of Africa. That is where there is an enormous gap. In some African countries, you can count the number of ecologists on the fingers of one hand.

There are whole new issues unfolding in Africa that are affecting development efforts that we have not coped with elsewhere in the world.

For example, it looks to us as though the loss of vegetation and land degradation is leading to a long-term decline in rainfall. If that is the case, and if we are thinking about an agricultural research strategy, then maybe we should not be researching corn so much, which requires quite a bit of rainfall, but researching sorghum or millet, which are much more drought resistant.

If we are thinking about a reforestation effort—and up until now, most of the efforts and the plans have been keyed to trying to satisfy firewood demands at the end of the century—but if the loss of vegetation is reducing rainfall, then maybe we ought to be thinking of something far more ambitious in an effort to restore the hydrological cycle that existed in Africa a generation ago.

Senator SARBANES. When you say "we" should be thinking, who is encompassed in that "we?"

Mr. BROWN. The governments of Africa first. They are the key actors. And then others.

Senator SARBANES. How do you think they are going to react to a development strategy which, as I look at it, takes them down a path entirely different from that pursued elsewhere in the world, on all the other continents? I know you base your argument for it on the unique ecological circumstances of Africa.

As I understand it, what you are saying in effect to African leaders is look, we want you to go down a certain path. But when they will look all around the world to see what everybody else had done, they will see that no one else has gone down that path.

You are saying to them look, the path that everyone else has followed, which ostensibly seems to be getting them ahead or at least seems to be the standard formula, just does not work for you.

I am not arguing at the moment whether that is right or wrong. But how do you get these leaders to agree with that view, and then how do they explain it to their people who say, aren't we being committed to a kind of backwater? It is a survival strategy, but that is about it. Maybe that is all that is available, however.

Mr. BROWN. I would say two or three things.

One, in looking at Africa, what we need to keep in mind is that the same thing that is happening in Africa is happening in other parts of the world.

Central America is en route to becoming an ecological basket case, if you will, with deforestation, soil erosion, alteration of the hydrological cycle—you name it. It is happening there.

The Andean countries: Per capita production in the Andean countries, if you chart it, shows that the decline is almost exactly

the same as it is for the continent of Africa, and for the same reasons—rapid population growth, deterioration of the resource base that underpins agriculture.

The Indian subcontinent in large areas—not so much the irrigated rice areas, but other parts of the Indian subcontinent—is facing the same sort of problem.

The difference is Africa has gotten there first. That is one point.

The second is that it should be clear to political leaders in Africa that the strategies of the last couple of decades are not working by any basic economic criteria you want to use—per capita food production, per capita income, external debt. It is not working.

This would suggest to most people that something different is needed.

I think the sort of analysis that I was mentioning earlier, projecting both the environmental and the economic trends simultaneously so that we can see what happens if deforestation continues, for example, will help people understand why some important shifts have to be made.

Now there is a tendency in Africa, and it is at least as strong there as elsewhere, to want to focus on more "glamorous" projects, such as the national airlines, the steel mills. The little country of Togo has 3 million people—it is smaller than Maryland—but it has a big steel mill of its own——

Senator KASSEBAUM. And an international conference center.

Mr. BROWN [continuing]. And an oil refinery, too. Neither of them are working, and there is not an internal market there.

So it is going to require a basic change in mindset. The question you are raising is how do you get that, how do you understand that.

I think the answer is research and information that indicates why continuing on the current path is going to lead to disaster.

Senator SARBANES. The FAO has a study scheduled to come out, I think, in February—is that correct—on the strategy for African food problems.

Mr. BROWN. Yes, something like that.

Senator SARBANES. Do you expect the sort of approach and recommendations in this paper [indicating] to be reflected in that study?

Mr. BROWN. I think to some degree. But that paper is being produced largely by agriculturalists, and they are not always sensitive to what is happening to the environmental support systems in agriculture.

So I would be a little surprised if it were as comprehensive as I think it needs to be in order to actually provide the strategic underpinnings for a reversal of the situation in Africa.

Senator SARBANES. What is the breakdown? It is failing to get your approach, which is a U.N. funded study, as I understand it, incorporated within that study.

This is what I think is happening to the Africans and to those who want to help them.

You get this study going, and it will come out in February; and as I hear this, you are then going to come along and say well now, this is not a bad study, but it really failed to take into accounts

points one, two, three, and four. And then everybody will be right back home again.

At what point do we finally get a strategy sensibly based for Africa to which the outside parties, donor countries generally agree, and which they, assist both bilaterally and multilaterally? The international agencies and the Africans themselves all say yes, this makes sense, we have it worked through, we have subscribed to the analysis and the recommendations, and we are now going to try to implement them. Then they fall short of the goals. But at least we are all moving on the same path.

Mr. BROWN. One of the handicaps that we face in dealing with Africa, as I mentioned earlier, is that we tend in formulating development strategy to look at it in economic terms or other specialized terms.

FAO will look at it in agricultural terms fairly narrowly perceived. This handicaps our efforts to deal with the problems in Africa because they cut across so many fields—agronomy, demography, meteorology, genetics, you name it.

It is difficult for people and for institutions to change their thinking quickly in response to new information and new insights.

I would say that there have been, for us at least, some very encouraging developments in this area. One is that the African Development Bank at its annual meeting in Brazzaville in May devoted part of that meeting to a seminar on desertification, what is happening in Africa and what the economic consequences of that were. I was invited to participate in that.

That is the first time the African Development Bank had done anything of that sort.

Closer to Washington, the World Bank has purchased 900 copies of this paper for distribution within the Bank, and it has been the subject of seminars, some of which we have participated in ourselves, in an effort to try to rethink strategy for Africa.

The Bank has also requested and been granted permission to translate it into French for use in the French-speaking countries.

So there is now an openness, a willingness to rethink strategy that simply did not exist as recently as 2 years ago.

In talking with senior people at the Bank, they are clearly thinking in ways that go far beyond anything that I have expected. I mean, basically we have a paper that says the time has come when we have to set-aside the traditional economic criteria and focus primarily on the environmental criteria for shaping development strategy in Africa, and the World Bank more or less adopting the paper and using it internally in a way that at least I have not seen before.

Senator SARBANES. If I could have just one more question, I would appreciate it.

Senator KASSEBAUM. Certainly, Senator Sarbanes.

Senator SARBANES. Do you think there should be a country strategy rather than an African strategy, or a group or a regional strategy within Africa?

For instance, in your report you say more than 40 of all Africans live in countries where grain yields per hectare are lower today than they were a generation ago. Of course, when you read that, it has a tremendous shock effect.

I know Nigeria is down by 3 percent. Now, if Nigeria were up by 3 percent, then I take it it would really read more than 20 percent of all Africa, or roughly 25 percent of all Africa.

Mr. BROWN. Nigeria would be a big factor.

Senator SARBANES. Yes.

If you just shifted Nigeria over, then that headnote there [indicating] would have been markedly changed.

I am not making a big thing of this. I am only using it to try to underscore the point of what I am asking: Is there a strategy for Africa, or should we have a strategy for some of the African countries?

Mr. BROWN. First, as to the point on land productivity, the important thing is not so much whether it is 40 percent or 20 percent of Africans living in countries with lower land productivity, but that land productivity for the continent as a whole has increased so little that a number of the countries have actually gone down.

If you look at per capita grain production, which is the more important indicator, then, of course, the whole continent is sliding, and very few countries have gone against that trend.

But, in terms of an African strategy versus a series of country strategies, it seems to me that there are benefits to be gained from economic integration within Africa in terms of economies of scales, as they begin to industrialized, in terms of moving agricultural commodities around. I note that this year, Zimbabwe, which has a grain surplus, is actually exporting to some other countries in Africa, for example.

So there is a need for something beyond country strategies in an economic sense. I mean, there used to be an East African sort of "Common Market," which has disintegrated and does not really function as such any more. But at one time that was very promising, and the countries that were within it were benefiting from it.

But in looking at some of the other issues, for example, the possibility that deforestation and land degradation may be reducing rainfall in Africa, any strategy to respond to that probably has to be continent wide or at least pretty close to it because if a few countries tried to turn that around by themselves, they probably would not succeed.

So, depending on whether we are looking at agricultural trade or economic integration or restoring the hydrological cycle, I think we have to think in different levels. But if you have someone, like the Bank, trying to orchestrate the continental response and regional responses within, then I think you have a much better chance than if you just have 52 country strategies operating independently.

Senator SARBANES. Thank you.

Senator KASSEBAUM. Senator Kerry.

Senator KERRY. Thank you very much, Madam Chairman.

Mr. Brown, you are obviously thinking in the broadest and most comprehensive terms about the problem. I am interested in what you have said about the resource-base approach. But I guess my question to you is this. If I read your comments correctly, you are also suggesting that the World Bank is the best vehicle to try to bring that together.

I am not sure that at least I see the direct correlation of their ability to be able to address that.

The Chairperson asked a few question on that and I wonder if you would perhaps give us a greater sense of how that could happen.

Mr. BROWN. In looking at a resource-base approach, there is a need for analysis of what is happening to the resources that underpin the African economies. Some of the best work on that is now being done at the World Bank.

If you look at this paper [indicating], the interesting thing is that we actually built this in large part—not entirely, but in large part—on Bank research being done by people in forestry and soils and environment and demography, and brought it together.

No other institution in the world has that operational research capacity in the way that the Bank does.

The Bank is in the individual areas on the cutting edge, and what they have not yet done and what I think we help them do is to bring that research to bear on overall policy strategy thinking for Africa.

Senator KERRY. Are you suggesting they really become involved in trying to mobilize the political infrastructure to respond to this?

Mr. BROWN. Well, in doing the sort of research that needs to be done, they could be making an important input into that.

I think we do need to realize that what we are talking about here is a need to mobilize public support. The situation in Africa will not be turned around unless it is broadly supported by people within Africa and outside Africa, and by people who have some shared concept of what is happening and what needs to be done to turn it around.

Another reason for suggesting that the Bank take a lead role is that in a lot of countries, basic reforms have to be undertaken—whether it is agricultural price policy or whether it is shifting away from heavy reliance on parastatal agencies that are not very efficient or whether it is population policy or demilitarization. I think the Bank is probably the only institution at the international level that can attempt to bring about those reforms in exchange for the sort of support that is needed.

If you look at the other U.N. agencies, they are so politicized that they really do not have the leverage and the strength to do that.

I think it is an important part of the turn-around effort. A lot has to happen in Africa in terms of priorities and policies.

Senator KERRY. With respect to the immediate debt problem and the resources it obviously would take to accomplish what you are talking about—and you may have addressed this before I got here, and I apologize if you did—what are you suggesting? Is it that we need some kind of writedown, transferral into grants, total forgiveness, 75-percent forgiveness, as has been suggested? Where do we go?

Mr. BROWN. I think a number of things have to be looked at.

I do not think there is much question now that the debt situation in Africa is moving rapidly to the unmanageable level in a great many countries. There is just no prospect at all that they are ever going to be able to respond in a conventional way to that debt.

In many cases, even the interest payments are not being made anymore, and the interest is being capitalized and the debt grows larger.

It seems to me that among the things that have to be looked at include, militarization. I just do not think governments in Africa can afford any longer to spend a lot on militarization. Another thing that I think has to be done is we have to devise—this is not only for Africa, but for many other Third World countries as well—some way of incorporating, of retaining the debt payments within the country to try to get the economies going again.

For example, one proposal that I have seen recently was by someone from I believe the Hoover Institution, on the west coast, who proposed setting up in a country like Peru, for example, a supernational lending body, where part of the interest payments being made to international lending institutions would remain in this lending institution to be funneled back. And the lending institutions, the private lending institutions, in exchange would get shares in the firms that were being invested in or established.

I think we are at the point where we have to consider something like that. That seems to me to be one of the more viable, workable suggestions. As you know, there have been dozens of proposals for how to handle what is becoming an unmanageable situation.

My colleague, Jodi Jacobson, and I were looking at the debt situation in Morocco, for example, which is not even usually thought of as one of the most troubled countries in Africa. Morocco's external debt is now very close to its GNP. The chances of Morocco even paying the interest on it any more are almost nil.

Senator KERRY. Well, there are many people who argue that, absent some fundamental reforms, economic and political, almost anything we do is simply going to compound the current problem. I will be very quick because I know we are running short on time.

What is your judgment with respect to our ability—and this also ties in, I think, to Senator Sarbanes question? Do we look at our ability to get those reforms on a country by country basis and tailor a program that way, which defeats somewhat your broader resource base approach, or is there a way in which you can get some assurances that we are not simply compounding the problem and address it in a larger context?

Mr. BROWN. One of the things that the U.S. Agency for International Development has done in Africa is set up a fund. I think it is $500 million or so. But it is not earmarked for particular countries, but will be used in those countries that show that they are prepared to undertake the kind of reforms needed to get things back on track.

I think that is a useful approach—reward those who are prepared to bite the bullet and make the changes, whether it is militarization or family planning or whatever. Without the reforms, for many of these countries there just is not much hope of getting things turned around.

The main thing I would add to the AID example is to again stress the necessity of looking at the problem in a broader context than has been done. For instance AID is now looking at food price policy, which is terribly important, but I think we ought also to be looking at reforestation and the resource base restoration efforts that are going to be needed, and ought to be tying our assistance to those kinds of efforts.

Senator KERRY. Thank you, Madam Chairwoman.

I would like at this time to simply say that I am going to have to be going in and out, as we are wont to do in this process, and I apologize to others for that fact.

Senator KASSEBAUM. Thank you very much, Senator Kerry.

I would like to close this portion with a brief comment that I think all three of us have expressed. It seems to me that it is going to take a lot of patience and perseverence to work for change within African countries. I don't know that this can be imposed.

It seems to me, as you have pointed out and as we have said, that the governments themselves are going to have to recognize the importance of work in their own country, an indigenous recognition. I don't think Peace Corps or AID or great numbers of people going to countries to plant trees will be the answer. I think that, to be successful, it is going to have to come from within, with our support and encouragement.

It is something, as you say, that does not give us a lot of time. But we have to begin to focus and I think focus in a steady fashion.

Mr. BROWN. If I could make one more comment on that. Once you get out into the countryside in Africa, you begin to realize how little information they have. A number of Africans have made the point to me that we have far more information in Washington, even at the Worldwatch Institute, than many African governments have on the issues we have been talking about.

So I think that to the extent we, in the U.S. Government, through AID can support research and information dissemination on the issues that we have been talking about, I think we can further that process of helping them understand what needs to be done and why they have to make some important economic and social course corrections.

Senator KASSEBAUM. Mr. Brown, you might be interested in knowing that Robert Wesson, from the Hoover Institution, who wrote the piece you referred to earlier, is going to be testifying later this morning.

Mr. BROWN. I think it is something deserving of consideration and I commend you for having him here.

Senator KASSEBAUM. Thank you very much for offering your testimony and your comments today.

My apologies to everyone who is standing. For once, there seems to be a great deal of interest in Africa. In many of the hearings over the last 4 years that we have held in the larger hearing room, there was hardly anybody there. So we thought we would have it in a smaller room this morning. But we seem to have expanded beyond our capacity.

Thank you very much, Mr. Brown.

Mr. BROWN. It was my pleasure.

Senator KERRY. They always say in politics that a crowded small room is better than an empty large one.

Senator KASSEBAUM. I hope the people who are standing feel that way.

It is a pleasure to welcome our second panel, consisting of the Honorable John Whitehead, Deputy Secretary of State and the Honorable David Mulford, Assistant Secretary of the Treasury for International Affairs.

I particularly appreciate both of you coming.

Mr. Whitehead, you have been on a busy mission to the Middle East and have just gotten back, and Mr. Mulford, you have been in Seoul on another important mission.

Thank you both very much for coming this morning.

STATEMENT OF HON. JOHN C. WHITEHEAD, DEPUTY SECRETARY OF STATE

Mr. WHITEHEAD. Thank you very much, Senator Kassebaum. It is a pleasure to be here with you this morning.

I appreciate this opportunity to discuss the African economic crisis, its roots, and what we together with many of the African governments can do about it.

I have submitted a more detailed version of my remarks for the record.

This is a propitious time for this hearing. Much has been happening in Africa in recent years. The opportunities for us to join in a more effective effort there are greater than during any time in the recent past.

At the same time, the needs are more urgent.

The State Department, AID, and Treasury, have been working very closely over the past several months on these issues. We have developed a significant, new proposal for Africa and other poor countries, which Secretary Baker presented at the annual IMF-World Bank meeting in Seoul just 2 weeks ago.

This proposal offers a comprehensive approach to Africa's problems of growth and development. It calls for a much more coordinated international effort and, particularly, for a stronger relationship between the IMF and the World Bank.

Part of this proposal was adopted at Seoul, and we have strong indications of interest from the African beneficiary countries and from other potential donor countries on the broader aspects of our proposal.

Sub-Saharan Africa is in the most profound economic crisis of its history—a crisis many years in the making. The causes of this crisis, aggravated by the severe drought of the past several years, are many and complex.

African countries came to independence by and large less developed than those countries in other continents. They have suffered from deteriorating terms of trade during the last several years. Altogether, sub-Saharan Africa's terms of trade have declined by approximately 13 percent since 1977, with each 1 percent costing these countries about $200 million in lost net export earnings.

But Africa's development potential has been further undermined by a series of policy factors which, in our view, represent equally fundamental roots of the problem. These include inappropriate domestic economic policies based on an overreliance on the public sector and inadequate attention to private sector development and free market factors; disastrous neglect of the all-important agricultural sector, in which over 75 percent of Africans are employed; a population explosion. Africa now has the highest population growth rate in the world, over 3 percent per annual.

Finally, included, too, is the rapid buildup since the 1970's of African external debt, with a resulting heavy economic burden of debt servicing.

From 1973 to 1983, Africa's medium and long-term debt rose from $14 billion to $66 billion.

As a result of these factors, Africa faces a crisis of growth. The average African today is poorer than he was in 1970. According to World Bank data, average per capita GDP in Africa has declined by about 4.5 percent since 1970.

Unless current trends are reversed, African standards of living will continue to deteriorate.

Without renewed growth, the threat of famine and starvation will continue. Without renewed growth, African countries will increasingly be subject to political upheaval and instability.

Our policy toward the continent of Africa is based on a search for peace, stability, economic growth, and development. Those objectives are intimately related, are widely shared by most African governments, and are mutually reinforcing.

The challenge today is to create an environment in which Africa can get back on the path of growth and pursue those objectives.

To encourage growth, some major policy changes had first to take place in Africa, and the donor community has had to change the way assistance was provided.

This need for policy change has thus been the focus not only of recent United States economic policy in Africa, but also of the World Bank, the IMF, of other donors, and of the African governments themselves.

We have made policy reform one of the pillars of our assistance program in Africa, and a major part of our dialog in international financial institutions.

African governments have made it a central concern, as well. There is a definite trend now toward policy reform, designed to encourage the private sector and to reduce the role and size of State involvement in the economy.

Let me cite some examples.

Twelve African countries have taken strong steps in an effort to stabilize their economies by reducing government deficits and limiting credit to the public sector. In Zaire, the central government has converted a deficit equivalent to 6 percent of GDP in 1982, to an anticipated surplus in 1985.

Fourteen countries have allowed agricultural prices to rise substantially toward market levels and have liberalized the marketing of agricultural products.

In Somalia, all price controls on produce and internal agricultural marketing restrictions have been eliminated.

Eleven countries have begun to reform their public commercial enterprises. Guinea expects to reduce the number of such enterprises from 150 to 15.

The United States has played a positive and influential role in this process. Aid to Africa has increased steadily under this administration. We now provide a total of more than $1 million a year in regular assistance to the 46 countries of sub-Saharan Africa, a fivefold increase over a decade ago.

In addition, the American people and the U.S. Government responded in extraordinary ways to the devastating drought and the terrible specter of famine. Our emergency aid in fiscal years 1984 and 1985 was itself more than $1 billion.

In addition, private American donations have amounted to more than $200 million.

What I want to emphasize, however, is that our assistance policies now focus on the need for recipient government policy reform. Since fiscal 1982, we have increasingly used our balance of payments assistance to Africa to promote trade liberalization, agricultural price changes, reductions in the number and influence of public commercial enterprises, and improved climate for private investment and other reforms.

Evidence of this can be found in Senegal, Sudan, Somalia, and Kenya.

Last year, we launched the African Economic Policy Reform Program—AEPRP—which provided additional and more flexible forms of support to those African countries which were not major recipients of U.S. balance of payments aid and which were prepared to undertake significant reforms.

Our policy reform program was a precursor and has given impetus to the creation of a similar program, the World Bank's special African facility, a facility which, together with bilateral funds available for cofinancing, will have about $1.2 billion over 3 years to finance policy reform programs in Africa.

We have coordinated our policy reform efforts closely with the World Bank, and as the Bank's facility enters an operational phase, we will have greater opportunities for such cooperation.

As important as this fundamental shift in thinking and policy is, Africa's return to growth will not be as rapid or dramatic as any of us would like. Africa still depends in large part on exports of raw material for which prices remain depressed. With proper incentives, new export sectors, especially in agriculture, will develop.

But this will take time.

Meanwhile, Africa suffers from a major debt problem, and serving that debt directly affects Africa's ability to promote the growth it so desperately needs. Indeed, without more resources for growth-oriented investment, Africa's recent reform efforts will stumble because of continued stagnation and the political resistance and instability that stagnation breeds.

We already see the manifestation of this problem in several cases where reform has been significant.

For example, in Zaire, which has adhered closely to the reform recommendations of both the IMF and the World Bank since 1982, debt service takes almost 60 percent of the domestic budget, crowding out needed services and infrastructure maintenance.

If nothing is done, it will grow to more than 90 percent by 1990, clearly an intolerable situation.

In Zambia, the government's inability to repay mounting debt is holding Zambia back, even though it has just adopted a major reform of its trade and marketing structures. Somalia, Liberia, Gambia, and many, many other African countries face this same problem.

So we are at a critical turning point? We must enable this process of reform and growth-oriented policies to go forward, or we will witness further stagnation, loss of will, backlash and potential instability.

Our friends in Africa, those on whom we count for many things and who have joined us in taking sound steps to restructure their economies on free market principles will be the ones most threatened.

It is for this reason that the administration has put so much effort into the proposal which Secretary Baker made at Seoul, and which my colleague, David Mulford, will describe to you today in greater detail. This proposal would, in the first instance, increase substantially the amount of concessional financing Africa and other poor countries could receive from the IMF through the Trust Fund.

Our broader proposal calls for a greater role for the World Bank through increased structural lending and by putting more World Bank resources into the poorer countries.

The success of this broader approach depends on a stronger relationship between the World Bank and the IMF, working together with African countries to develop comprehensive, growth oriented, economic programs that both World Bank and IMF Trust Fund financing would support.

The proposal for channeling Trust Fund repayments to the poorer countries was adopted by the Interim Committee at Seoul. We are now receiving indications of support and interest for the broader proposals from both Africans and from other donors. Much remains to be done to develop this broader proposal and to give it specific form.

We plan to work hard with our African and OECD friends and with the international financial institutions to make it work.

In the context of this broader approach, we would be prepared to consider additional resources for this effort in coming years if other donors also make equitable additional contributions.

We know the magnitude of the task is great. I am convinced, however, that, while a sustained effort by the international community and the United States will be required, this joint effort can ultimately provide the very engine of growth needed to reduce Africa's unhealthy dependence on foreign donor assistance.

However, we can only go forward with such an additional effort when the mechanisms of coordination are established and the pace of structural adjustment in Africa makes the use of such resources productive.

I am encouraged that we can find solutions to Africa's current problems. African countries have already embarked on an economic reform process in a wide range of areas. The international community in turn is responding with more flexible forms of assistance, targeted to structural change in favor of market forces.

We are addressing the special problem of debt. The United States has played a leading, catalytical role in all these efforts. But clearly the task ahead is beyond the capability of a single country. As the Bonn Summit Experts' Report stated, "The magnitude of the challenge calls for a renewed and strengthened international partnership with Africa."

We wholeheartedly accept this call for action, and we have begun.

Thank you.

[Mr. Whitehead's prepared statement follows:]

PREPARED STATEMENT OF JOHN C. WHITEHEAD

I appreciate this opportunity to discuss the "African economic crisis," its roots, and what we and many Arican governments can do about it. This is a propitious time for this hearing. Much has been happening in Africa in recent years. The opportunities for us to join in a more effective effort there are both greater than any time in the recent past and, at the same time, more urgent.

The State Department, AID and Treasury have been working very closely over the past several months on these problems of Africa. We have developed a significant new proposal for Africa and other poor countries which Secretary Baker presented at the annual IMF/IBRD meeting in Seoul just two weeks ago. This proposal offers a comprehensive approach to Africa's problems of growth and development. It calls for a much more coordinated international effort, and particularly a stronger relationship between the IMF and the World Bank. Part of this proposal was adopted at Seoul, and we have strong indications of interest from African and donor countries in the broader aspect of it.

Sub-Saharan Africa is experiencing the most profound economic crisis in its modern history -- a crisis which has been building up for years and the causes are many and quite complex. This year's drought dramatized and aggravated Africa's economic crisis -- but it was not its principal cause.

To begin with, I wish to highlight something which we should not forget when we are talking about Africa. Africa is a continent full of young nations, most of which have only become independent during the past 25 years. Most African countries have had to devote considerable attention, resources, and energy to this important effort, even at a cost to their fragile economies.

Compounding their existing problems of nationhood, most African countries at independence opted for the path of African "socialism," giving high priority to industry and a low one to agriculture. For both political reasons -- i.e., catering to the needs of the small but influential urban population -- and short-sighted economic ones, most African nations held down the price of agricultural products and restricted marketing channels, to obtain "cheap food". African leaders tended to think that industry provided the best avenue for development and therefore channeled the highest percentage of resources to this sector, often investments which made no sense in terms of the resources available and of the internal market. Too many costly investments were made for prestige reasons or were designed on the basis of overly optimistic assumptions. Moreover, relatively little of the money for investments came from domestic savings and therefore most had to be borrowed abroad. The results have been all too apparent.

Despite a substantial infusion of capital, Africa has shown one of the lowest returns on investment in the world --10 percent in the 1970 - 1980 period as opposed to 20.5 percent for all developing countries. In addition to ill-advised African economic policies, uneconomic projects were supported by donor governments (often pushed by private companies with a stake in such projects) or multilateral institutions. Since donors designed the projects and/or accepted the feasibility studies showing expected return on investment, it is apparent that they share responsibility with African governments for some of the capital intensive carcasses one can point to throughout Africa.

For whatever reasons, it is apparent that the economic policies pursued by most African countries proved disastrous. Rather than adjust to the poor results, many African countries borrowed heavily during the 1970's, when petrodollars were plentiful and available for recycling and net capital flows were rising. These capital flows permitted countries to postpone needed structural adjustments until their internal situation had deteriorated to the level we find today. Now, they can no longer ignore needed policy changes and these reforms will not be easy politically.

In the agricultural sector, where over 75 percent of the African labor force is employed, developments since independence have been catastrophic. In the 1970's, only eight out of thirty-nine African countries experienced positive growth in per capita agricultural production. Since 1970, per capita food production in sub-Saharan Africa has fallen 20 percent and cereal imports have more than tripled.

In the context of its still limited resource base, a population explosion has also contributed to Africa's declining standard of living. Africa currently has the highest rate of population growth in the world -- over three percent -- and was the only major geographic area in which the rate continued to increase in the 1970's. By the year 2020, if the current trend continues, the African continent will have a population of some 1.2 billion -- a tripling of the current population of about 430 million in a period of 35 years. With population growth outstripping production gains in agriculture, it is clear that the food imbalance in Africa will continue to grow unless steps are taken to bring population growth down and/or agricultural productivity up.

Then there also the negative effects of external factors to which African countries are particularly vulnerable. The oil shocks of the 1970's, the world recession of the early 1980's, soaring interest rates, and plummeting demand and prices for its primary commodity exports all aggravated the already bleak economic environment for Africa.

African countries are highly dependent on imports of raw materials and capital equipment needed for their internal development. At the same time, many African countries depend upon one or two commodities for a high percentage of their exports and therefore have been particularly susceptible to world price declines or, in the case of agricultural products, production drops caused by the weather. In the case of copper, for example, the price has dropped around 35 percent since 1980.

Unable to earn foreign exchange necessary for these imports, African countries resorted to heavy external borrowing. In the decade 1973 - 1983, Africa's medium- and long-term debt showed an almost five-fold increase, rising from $14 billion to $66 billion. The sharp deterioration of Africa's terms of trade, as well as of export volumes of commodities important to Africa, has continued to make it difficult to service this debt -- and the result is that the debt has continued to grow.

Although Africa's debt is small relative to that of the rest of the world -- some eight percent of the total external debt of all developing countries -- it is large relative to the size of African economies and their ability to service it.

It is also apparent that Africa is more dependent than other areas on financing from international institutions -- a type of financing which cannot be rescheduled. Countries in the region have made extensive and repeated use of IMF resources -- resources which carry relatively hard terms. In the past five years, Africa's indebtedness to the IMF has soared and at the end of 1984 stood at $5.4 billion -- an amount with a relatively short pay back period.

Commercial banks have put a further squeeze on Africa's foreign exchange availabilities because they have been pulling out rather than putting in new money into Africa. According to the IMF, new medium and long term commercial bank credit commitments to Africa have declined by 80 percent since peaking at $2.2 billion in 1982. Net disbursements of medium and long term commercial bank credits, meanwhile, have turned negative, leaving commercial banks with $17.6 billion in outstanding medium and long term loans to Africa in June 1984, versus $18.3 billion only eighteen months earlier.

Africa also predominates in reschedulings within the Paris Club context. Fifteen African countries rescheduled their debts to Paris Club creditors since 1983, some more than once. Zaire has had seven Paris Club reschedulings since 1976; Liberia and Sudan each have had four.

In 1984, eight African countries had debt-service ratios of over 50 percent of export earnings, and another nine had debt-service ratios of over 30 percent. Sudan, Madagascar, and Mozambique owe more in debt-service each year -- before rescheduling -- than they earn in exports. Other countries confront or will confront debt servicing burdens of comparable degrees of severity. I will briefly give you a few illustrations.

Take the example of Zaire, which after stop and go implementation of IMF programs between 1976 and 1982, finally began serious pursuit of adjustment in 1983. There have been some positive effects. As a result of an 80 percent devaluation in late 1983, reforms in the foreign exchange market and financial management, budgetary discipline, and price liberalization, GDP growth was up to three percent in 1984 and inflation came down from over 100 percent in 1983 to around 20 percent in 1984. However, despite generous Paris and London Club debt reschedulings, Zaire's debt is so large that it is not expected to be able to service its debt without substantial relief before 1990 at the earliest. Debt service consumes half of Zaire's budget, causing pressure to limit spending for economic development.

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In Zambia, following five IMF programs and three Paris Club reschedulings, is still in financial straits. Its external debt burden at year-end 1984 reached an estimated $4.4 billion, which is equivalent to 170 percent of GDP. Service payments on this debt are now scheduled to claim 70 to 80 percent of Zambia's goods and service earnings over the next five years, under best case assumptions.

From this historical perspective, we have a better appreciation of how Africa reached its current state of affairs. Africa today faces an economic crisis of historic proportions and needs the help of the world community to combat the immediate problems of hunger, the near-term problems of stabilization and reform; and the longer term problems of development. The average African today is poorer than he was in 1970 and, unless current patterns change, is likely to see his standard of living deteriorate further. The challenge for African governments themselves is how to develop and maintain the political leadership and policies required to bring about orderly transformation of African economies so that Africa can get back on the path of growth. The challenge for the United States, other donors, and international financial institutions is how best to support these efforts.

Without renewed growth, African countries will continue to be threatened by famine and starvation.

Without renewed growth, African countries will increasingly be subject to political upheaval and instability.

Without renewed growth, the economic crisis will continue.

We find it reassuring that there is a strong degree of consensus among African countries, d nor countries, and international financial institutions on the nature of Africa's economic crisis. This has not always been the case and should be regarded as significant achievement. We can now narrow the debate to what are the best ways to meet Africa's problems. Policy reform is no longer in principle a controversial concept. African countries openly admit that part of their troubles are directly attributable to domestic policy short-comings and have proceeded to implement a wide series of economic reforms. At the most recent OAU Summit, which was devoted almost exclusively to economic issues they recognized the importance of agriculture and "committed their governments to the gradual increase in the share of agriculture in national total public investment to between 20 and 25 percent by 1989."* This has been an encouraging development and deserves the support of the international community.

*OAU Heads of State Declaration on the Economic Situation in Africa, July, 1985.

If there is agreement that economic policy reform is necessary, what have the African countries done to take corrective action? Here again, we can share some positive information which shows that the reform process is well underway in Africa. I will cite a few examples of types of reforms undertaken in Africa since January 1984:

-- Twelve countries are stabilizing their economies by reducing government deficits and strictly limiting new credit to the public sector. In Zaire, for instance, the central government deficit on domestically financed operations has been converted from a deficit equivalent to 6 percent of GDP in 1982 to an anticipated surplus in 1985.

-- Fourteen have substantially increased agricultural producer prices and/or liberalized agricultural marketing. In Somalia, as one example, all producer price controls and internal agricultural marketing restrictions have been eliminated.

-- Eleven have begun to reform their parastatals. In Guinea, the entire publicly owned commercial banking system has been disbanded and replaced by private commercial banks. Moreover, further measures in Guinea are expected to reduce a set of 150 public commercial enterprises to a total of 10 to 15, including public utilities.

-- Nine are restricting public sector hiring and/or public sector wages. In Mali, a fixed nominal cap on government personnel expenditures originally established for 1985 is to be maintained at the same level throughout 1986.

-- Eleven have decontrolled some or all of consumer prices. Zambia, Somalia, Zaire, Guinea and Mauritius have all decontrolled a majority of their consumer products.

Others are radically reforming foreign exchange markets and introducing flexible exchange rate systems. Foreign exchange auction systems have already been introduced in Zaire and Zambia. In Somalia, virtually all commercial transactions are now settled on a free foreign exchange market managed through the commercial banks.

These reforms are important and we believe that they serve Africa's interests. Africa's increased well-being also serves the considerable U.S. interests in the region.

Broadly stated, priority U.S. strategic and political interests in Africa are similar to those we have in the rest of the world.

We have humanitarian interests in seeing that basic human needs are met in a continent which represents a considerable share of the world population.

We have important political relationships with many African countries which we want to maintain and to the extent possible strengthen. These countries are quite diverse, ranging from giant Nigeria, the mid-sized Senegal, to the small Mauritius. These are our friends and we need to bolster them politically and economically. It is apparent to all of us that one cannot separate economics from politics and that the two have a symbiotic relationship.

Africa is part of the world system and its views have substantial influence on its character. We must not forget that African countries comprise about one-third of the membership of the United Nations and that they play an important role in determining UN positions on political, economic, and technical issues.

Africa is well-endowed with mineral resources and we depend heavily on it for the supply of such critical minerals as chrome and cobalt. Africa's large size and location near Europe and the Middle East and along crucial sea lanes make it strategically important. The United States depends upon the cooperation of several African countries to maintain our naval access to this area, including the Indian Ocean and the Red Sea.

And lastly, and in terms most readily recognized by Americans, Africa is most important to us in cultural and human terms. Eleven percent of the population of the United States traces its roots to Africa. Moreover, the independence of most African countries took place during the same period when the United States was engaged in its civil rights expansion of the 1960s.

Freedom is the common bond between these two political processes and we share a stake in maintaining it where it already exists and extending it to areas where it does not. We and African countries share the goal of promoting freedom in Southern Africa.

What is the United States doing to help African countries put their economies back on a growth path?

We now provide over $1 billion annually in regular assistance to 46 Sub-Saharan countries. This represents a five-fold increase in aid levels since 1974 when we were assisting 12 countries in Africa. Africa's share of our total aid budget (excluding emergency assistance) has increased from 5 percent to about 15 percent during the same period.

We are the largest donor of food aid to Africa, providing slightly more than half of total food requirements this year under our emergency and regular food assistance programs -- about 3 million tons of food assistance valued at over $1 billion. In addition to food, we are supplying substantial amounts of emergency assistance to help meet the shelter, health, and logistical needs of the drought-affected populations. We must also take pride the large and generous contributions from the U.S. private sector, amounting to over $150 million. These contributions represent the community spirit of Africa -- individuals caring and sharing to help their fellow man.

Just during this Administration the U.S. has increased its regular economic aid to Africa by over 55 percent and has become the second largest bilateral donor to Africa. We have gone from providing 4 percent of Africa's development assistance to 12 percent. Nevertheless, our role has to be seen as part of the larger donor activity. We must ensure that our aid programs mesh with and do not duplicate the contributions made by our OECD partners, the Arab funds, and international financial institutions, which account for 86 percent of assistance received by Africa. It is noteworthy that the Eastern Bloc countries provide only about two percent of Africa's economic assistance.

The four major "pillars" of our assistance strategy are: policy reform, strengthening of the indigenous private sector, institution building, and technology transfer. They are cross-cutting themes which reenforce each other.

Our economic policy reform programs seek to create incentives for growth and to enable African farmers as well as businessmen to play a more dynamic role. At the same time, they help develop the technologies, institutions and human capital required for sustained growth.

We are placing increased emphasis on promotion of private sector activity in Africa and using private sector rather than public sector channels to deliver our aid resources to Africa. We know that the private sector is an effective engine for growth. A World Bank study has shown that less developed countries which created favorable environments for the private sector had much higher growth rates that those which did not.

We are supporting agricultural pricing and marketing reforms, privatization of parastatals, and increased farmer productivity through investments designed to improved technologies, access to markets, productive infrastructure, and the supply of fertilizer and other agricultural inputs. Furthermore, President Reagan in January 1985 announced his support for a Food for Progress Initiative which would provide food assistance on a multi-year basis to countries desiring to undertake policy reforms in the agricultural sector. The legislation required for this new initiative is currently under consideration in Congress and hopefully will be approved soon.

We are placing a major emphasis on agricultural research to develop technologies that are affordable and profitable for the average farmer. We foresee spending about one billion dollars for agricultural research in Africa over the next fifteen years.

In the area of population, we are helping integrate family planning into public health systems and develop private sector services.

An increasing share of our assistance to Africa is in the form of quick-disbursing program rather than project assistance. We provide short-term balance of payments relief through ESF funded commodity import programs and cash grants (about $240 million), and PL 480 Title I food sales programs ($208 million). Such assistance helps countries experiencing temporary food or foreign exchange shortages obtain food and other vital imports or repay foreign loans.

We are increasingly conditioning this balance of payments assistance on economic structural reforms (e.g. trade liberalization, agricultural market liberalization, civil service reform) to create a favorable framework for medium and long term growth. At the same time, we are using sector and project assistance (about $70 million) to support key policy and institutional reforms.

Last year we launched the African Economic Policy Reform Program (AEPRP), which provides additional, more flexible assistance to African countries undertaking critical policy reforms. In FY 85 programs totalling $75 million were developed for Malawi, Mauritius, Mali, Rwanda and Zambia and, although the programs are still in the initial phases of execution, we can point to some important successes.

The Policy Reform Program is a precursor and gave impetus to the creation of a similar program, the World Bank's Special African Facility -- a facility which together with bilateral funds available for co-financing will have about $1.2 billion to finance policy reform programs in Africa. We have been coordinating our policy reform efforts with the World Bank and, as the Bank's Facility enters an operational phase, it will provide stronger opportunities for cooperation.

Furthermore, in developing the FY 85 programs, the Policy Reform Program has served as a catalyst for action on the part of donors and the World Bank. These programs have moved the reform process more quickly and broadly than would have been the case without our presence. In Rwanda, our Policy Reform Program carried the policy dialogue beyond the project level and is the leading edge of what will be a major structural reform program by the World Bank. In Mali, our program succeeded in concentrating the energies of various different Malian ministries on the implementation of reforms by the IMF and UNDP. In Zambia, our program supported World Bank efforts to rehabilitate the agricultural sector by reducing the political costs of implementing reforms.

The Policy Reform Program has already had an important impact on government views of the reform process in those countries selected for the program in FY 85. In Rwanda, the Government set up a special inter-departmental committee to develop and review policy reform proposals. In Mali, our program has given an impetus to the government's own efforts to reduce the public sector's role in the economy. In Malawi, we have had a major impact on the government's views of what reforms are needed in the agricultural sector.

Earlier, I described the seriousness of economic problems and the heavy debt burdens on the region. If recent progress in awareness of the need for policy reform is to bear fruit, the donor community must support it with a coordinated assistance program. Failure to address these problems will give credence to critics of reform and undermine the efforts of those leaders in Africa who have had the courage and foresight to take strong action on their internal economies and who have recognized their obligations to repay their debts. The recent OAU Summit reaffirmed the acceptance by African states of their debt obligations but urged steps to make that burden more manageable.

It is for this reason that the Administration has put so much attention on the proposal which Secretary Baker made at Seoul and which my colleague David Mulford will describe to you in more detail. This proposal would in the first instance increase substantially the amount of concessional financing African and other poor countries could receive from the IMF through the Trust Fund. Our broader proposal calls for a greater role for the World Bank, through a greater amount of structural lending and by putting more World Bank resources into the poorer countries. The success of this broader approach depends on a stronger relationship between the World Bank and the IMF, working together to develop with African countries comprehensive growth-oriented economic programs that both World Bank and IMF Trust Fund financing would support.

The proposal for channeling Trust Fund repayments to the poorer countries was adopted by the Interim Committee at Seoul. We are now receiving indications of support and interest for the broader proposals from both Africans and other donors. Much remains to be done to develop this broader proposal and give it specific form. We plan to work hard with our African and OECD friends and in the international financial institutions to make it work.

In the context of this broader approach we would be prepared to consider additional resources for this effort in coming years if other donors also make equitable additional contributions. We know the magnitude of the task is great. However, we can only go forward with such additional effort when the mechanisms of coordination are established and the pace of structural adjustment in Africa makes the use of such resources productive.

What are the prospects for reversing Africa's economic decline?

I am optimistic. All we have to do is look at India which at one time found itself in much the same state as Africa and is now an economic success story. We have witnessed the dramatic turn around of China as its economic reforms are today providing suitable incentives for its people, particularly in the agricultural sector.

And so, we do have hope for Africa. All of us have learned from the past and have a more realistic perception of Africa's needs. As I have mentioned earlier, African countries have already embarked on an economic reform process in a wide range of areas. Clearly the task in front of us is beyond the capability of a single country. As the Bonn Summit Experts report on the African economic crisis states, "the magnitude of the challenge calls for a renewed and strengthened international partnership with Africa. Decisive action is required on the part of African governments and peoples, for their recovery and development; international action to supplement their effort is essential. It is proposed that the Summit countries and the European Community pursue and deepen consultations and collaboration with African nations leading to a true partnership in recovery and development."

We wholeheartedly accept the Bonn Summit report's call for action. A lot of work remains to be done. Let's do it.

Senator KASSEBAUM. Thank you very much.

Mr. Mulford, I think we will ask you to proceed and then we will have some questions for both you and Secretary Whitehead.

STATEMENT OF HON. DAVID C. MULFORD, ASSISTANT SECRETARY OF TREASURY FOR INTERNATIONAL AFFAIRS

Mr. MULFORD. Thank you, Madam Chairman.

Madam Chairman, I welcome this opportunity to speak before you on the difficult economic and financial situation facing the countries of sub-Saharan Africa.

The administration's concern for this region is evident from the level of our economic assistance. It was forcefully restated in the new ideas Secretary Baker put forward at the IMF-World Bank annual meetings in Seoul for enhanced IMF and World Bank assistance to the poorest debtor countries.

As we review the situation in sub-Saharan Africa, one point is clear. The region is suffering from economic problems that took many years to develop and that will require a long and difficult effort to correct.

Nonetheless, this is an effort to which we are dedicated, and we are hopeful that reform efforts now underway and the proposals we have recently advanced in Seoul represent a start toward their resolution.

Deputy Secretary Whitehead has already outlined for you the history and dimensions of the region's economic problems, and U.S. bilateral efforts to address them.

For my part, I would like to focus on the financial outlook these countries will confront and the role we see for the international financial institutions in promoting economic recovery.

Looking ahead over the next few years, the dominant influence on sub-Saharan Africa's economic performance will be the region's own economic reform efforts.

However, given the weak economic situation of these countries, the availability of external finance will also have an important impact on their growth prospects.

Treasury projections of net financial flows to the region indicate that annual net inflows over the 1985–91 period may be 30 percent below the levels in 1980–82.

These very tight financial constraints point up the need for determined efforts at economic reform in order to improve economic performance and restore creditworthiness.

Fortunately, a consensus is emerging on the need for policy reform, and the donor community is working to design aid programs which will promote recovery and growth while recognizing the limitations posed by the region's relatively new institutions, limited technical manpower, and overall absorptive capacity.

We look to the multilateral institutions, especially the IMF and the World Bank, to take the lead in this process.

The World Bank group is a major economic presence in sub-Saharan Africa, providing $10 billion to the region between 1981 and 1985.

Despite these efforts, economic deterioration has accelerated, leading Bank management and member governments to look to new approaches to the problems of the region.

The Bank has strengthened the administration and management of its African operations and has developed new lending instruments suited to the changed economic circumstances of its borrowers. These include the Structural Adjustment Lending Program, which provides fast disbursing support to countries implementing programs of structural adjustment, and less comprehensive sector adjustment loans, useful where institutional weakness hinder the design and implementation of more comprehensive reform programs.

We have also welcomed the emphasis placed on encouraging policy reform under the Bank's Special Facility for sub-Saharan Africa.

The United States has also led efforts to direct additional Bank group resources to the region. We have supported an increased IDA share for Africa, now 37 percent compared to a 26-percent share in fiscal year 1980–81, and would like to see it go still higher.

In the IFC, the United States was successful in gaining agreement to allocate a larger share of resources—24 percent—to sub-Saharan Africa under the corporation's new 5-year program.

Finally, the United States looks to the World Bank to take the lead in coordinating the aid efforts of bilateral donors in Africa through its consultative group process.

We would also like to see the African Development Bank and Fund play a greater role in addressing the region's problems and have supported efforts to strengthen the Bank's operations.

The IMF has the primary responsibility for addressing the balance-of-payments problems afflicting sub-Saharan Africa. IMF lending to sub-Saharan African countries increased significantly between 1980 and 1984, providing a total of $6.7 billion in balance-of-payments assistance.

Its share of total lending to the region increased from 7 to 11 percent between 1980 and 1983.

The Fund has encouraged policy adjustments to help these countries adapt to changed economic circumstances and position themselves for sustained growth. However, it has not been possible to address effectively the long-term structural problems of these countries through IMF Adjustment Programs within the short- to medium-term timeframe that is consistent with the IMF's role and operations.

Therefore, many countries in the region have made repeated use of IMF Programs to meet short-term financing requirements over an extended period of time.

This prolonged use of IMF resources by many countries in the region weakens the revolving character of Fund financing and may reduce resources available for other members.

In addition, an increasing number of countries in the region have fallen into arrears to the Fund—currently the number is seven countries—and arrears have grown rapidly.

Under current rules, countries in arrears may not draw IMF resources under existing programs, nor negotiate new ones; and in

the case of persistent arrears, a member may be declared ineligible to use IMF resources.

Continuation of such a situation represents a serious problem for both the countries and the IMF. We must address this problem and come up with a solution which preserves the financial integrity of the IMF, while being realistic about the ability of the countries to improve their economic situation, restore their credit worthiness and meet their financial obligations.

The failure of reform efforts in sub-Saharan Africa has many causes, including inadequate action by the countries themselves, adverse external developments and natural disasters.

However, in part, the lack of success arises from the fact that the economic problems of these countries require a comprehensive, medium-term reform effort, focused on their particular economic problems. A successful program should encompass both the types of structural changes supported primarily by the World Bank and sound macroeconomic policies which are the heart of the IMF programs.

The individual efforts of the IMF, the MDB's and bilateral donors, even though sound on their own terms, have not produced this comprehensive result. A new formula is needed to address the region's economic problems, based on closer coordination between the IMF and the MDB's and supported by bilateral official assistance.

The $2.7 billion of repayments flowing back to the IMF Trust Fund through 1991 provides a unique opportunity to launch such a comprehensive economic reform effort for Africa.

The United States, therefore, proposed in Seoul that these reflows be used to provide concessional financing in support of comprehensive economic reform for the poorest countries with protracted balance-of-payments problems, primarily in sub-Saharan Africa.

Under the U.S. proposal, funds would be provided on concessional terms to support multiyear, growth-oriented economic programs. This approach would include adoption of sound monetary, fiscal, and exchange rate policies, and the removal of structural impediments to production, savings, investment, and non-inflationary growth.

It would be absolutely critical that the Fund operate in close cooperation with the World Bank to achieve a consistent policy approach and create the fundamental conditions for growth.

Other participants in the Seoul meeting shared our desire to address the problems of the poorest countries, and the Interim Committee endorsed the proposed use of Trust Fund reflows. There was also a consensus on the need for close Fund-Bank cooperation.

The United States is also prepared to consider an even bolder approach involving joint IMF and World Bank programming. We believe that such an approach would guarantee close cooperation of IMF and World Bank assistance for the poorest countries, and encourage closer cooperation between the institutions in general.

It would insure that the institutions provide mutually consistent advice across the full range of their expertise.

A joint approach could also catalyze substantial, additional resources to support reform in sub-Saharan Africa. We noted in

Seoul that we were prepared to consider seeking resources in support of such an approach if other donors were also prepared to make equitable contributions.

However, a number of countries seem to be concerned about the concept of joint IMF-World Bank programming, and there has been some understandable reluctance to move into the unchartered waters of unified programming by the two institutions.

I believe this new approach is essential to insure that the IMF and World Bank are pulling in the same direction in the most effective manner possible. We are hopeful that others will recognize the merits of this approach and that a final agreement on it can be reached by the end of this year.

Whichever route is taken—continued separate programs with closer coordination between Fund and Bank, or a bolder joint program approach—we will attempt to insure that the Trust Fund reflows are targeted to help the poorest countries and their used based upon the adoption of macroeconomic and structural policy reforms which will improve prospects for sustained economic growth in sub-Saharan Africa.

In conclusion, it is clear that additional efforts are needed to address the economic problems of sub-Saharan Africa. Secretary Baker's proposals in Seoul have made a major step in this direction and provide a basis for discussion of further, bolder steps in the future.

I welcome your questions on these new ideas.

Thank you very much.

[Mr. Mulford's prepared statement follows:]

Prepared Statement of David C. Mulford

Madame Chairman and Members of the Subcommittee:

I welcome this opportunity to speak before you on the difficult economic and financial situation facing the countries of Sub-Saharan Africa. The Administration's concern for this region is evident from the size of our bilateral assistance program and the major emphasis we have placed on Africa in the lending programs of the multilateral development banks. It is also reflected in the new ideas Secretary Baker put forward at the Fund/Bank Annual Meetings in Seoul for enhanced IMF and World Bank assistance to the poorest debtor countries.

As we review the situation in Sub-Saharan Africa, one point is clear. The region is suffering from economic problems that took many years to develop and will require a long and difficult effort to correct. Nonetheless, this is an effort to which we are dedicated and we are hopeful that reform efforts now underway and the proposals we have recently advanced in Seoul represent a start toward their resolution.

Financial Outlook

Deputy Secretary Whitehead has already outlined for you the dimensions of the region's economic problems, and the factors which underlie them. For my part, I would like to focus on the financial outlook these countries will confront.

Looking ahead over the next few years, the dominant influence on Sub-Saharan Africa's economic performance will be the region's own economic reform efforts. However, given the weak economic situation of these countries, the availability of external finance will also have an important impact on their growth prospects. Treasury projections of net financial flows to the region indicate that financial constraints are likely to be an important factor in the region for the remainder of the decade.

Over the period 1985 to 1991, gross annual capital inflows are likely to remain flat while principal repayments on the debt built up in the 1972-82 period, including repayments to the

international financial institutions, rise sharply. The result will be to reduce projected net annual inflows during the period to roughly half the 1980-82 annual level. Even with continued generous official bilateral rescheduling, net inflows would be 30 percent below 1980-82 levels.

Implications for the Region

These very tight financial constraints point up the need for determined efforts at economic reform in order to improve economic performance and restore creditworthiness. Fortunately, a consensus has emerged among donors and many countries in the region that policy reform by Sub-Saharan African countries is a precondition for improvement in the region's economic situation, and that successful reform requires concerted support from donors. Furthermore, there is a growing awareness that improving the quality of external assistance is as important as its volume.

The multilateral institutions and donors are working together to design aid programs which will provide the greatest possible impetus for recovery and growth while recognizing the limitations posed by the region's relatively new institutions, limited technical manpower, and overall absorptive capacity.

Role of the Multilateral Institutions

You heard earlier this morning about U.S. bilateral efforts to support policy reform and renewed growth in the region. I would like to concentrate on the central role of the multilateral financial institutions, both the IMF and the multilateral development banks (MDBs), in supporting the recovery process in Sub-Saharan Africa. We look to the multilateral institutions, especially the IMF and the World Bank, to take the lead in formulating and promoting appropriate economic policies, and have been working closely with all the institutions to ensure that their resources are used wisely to support reform.

The World Bank

The World Bank is a major economic presence in Sub-Saharan Africa. The World Bank group provided $10 billion to the region between 1981 and 1985 for sound investment projects and to provide policy guidance and technical assistance. Despite these laudable efforts, however, economic deterioration has accelerated. Both Bank management and member governments have recognized that major changes are needed in the overall approach of the financial institutions and bilateral donors if the decline is to be halted.

The United States has worked closely with Management and other members to improve the effectiveness of the Bank's assistance efforts in Africa. We have supported Bank efforts to strengthen the administration and management of its African operations, and development of new lending instruments in response to the changing economic circumstances of its borrowers.

The principal new instrument is the Structural Adjustment Lending (SAL) program, which has provided valuable fast disbursing support for countries willing to implement programs of structural adjustment (10 SALs have been undertaken by six African countries since 1980). We have also supported less comprehensive sector adjustment loans for Sub-Saharan countries where institutional weaknesses hinder the design and implementation of more comprehensive reform programs, as long as effective conditionality is maintained. We have similarly welcomed the emphasis placed on encouraging policy reform under the Bank's Special Facility for Sub-Saharan Africa as supportive of our broader efforts in the Bank.

The United States has also taken a leading role in directing additional Bank group resources to the region. Recognizing the particular importance of concessional IDA funds to the poorest countries in Africa, the U.S. was successful in making Sub-Saharan Africa the highest priority for allocation of IDA resources. While the current 37 percent share of programming is a great improvement over the 26 percent share in FY 1980-81, we believe it should still go higher.

In the IFC, the United States was successful in gaining agreement to allocate a larger share of resources (24 percent) to Sub-Saharan Africa under the Corporation's new five-year program. The IFC will focus on promotional activities and small scale projects appropriate to the region's economic circumstances in order to strengthen the role of the private sector.

Finally, the U.S. looks to the World Bank to take the lead in coordinating the aid efforts of bilateral donors in Africa through its consultative group process. We are working to coordinate our bilateral assistance more closely with the World Bank and other donors and have in selected cases directly associated our aid with Bank policy reform programs in Africa.

In addition to supporting World Bank efforts, the U.S. has been a major supporter of the African Development Bank and Fund. This is the only institution dedicated solely to the development of Africa, and we would like to see it play a more important role in addressing the region's problems. The Bank and Fund committed $3.7 billion to the region over the FY 1980-84 period.

Role of the International Monetary Fund

The IMF has the primary responsibility for addressing the balance of payments problems afflicting Sub-Saharan Africa, and has played and will continue to play a major role in the region. IMF lending to Sub-Saharan countries increased significantly between 1980 and 1984, providing a total of $6.7 billion in balance of payments assistance. The IMF's share of total lending to Sub-Saharan Africa also increased from 7 to 11 percent between 1980 and 1983, as Fund resources were increasingly utilized to meet short-term financing needs. Outstanding IMF loans to Sub-Saharan countries currently account for nearly 15 percent of

total outstanding obligations to the IMF, although their share of total IMF quotas is only 3 percent.

The Fund has encouraged policy adjustments to help these countries adapt to changed economic circumstances and position themselves for sustained growth. However, it has not been possible to address effectively the long-term structural problems of these countries through IMF adjustment programs within the short- to medium-term timeframe that is consistent with the IMF's role and operations. Therefore, many countries in the region have had repeated recourse to IMF programs stretching over an extended period of time. For example, thirteen African countries have had more than four upper-tranche programs in the last ten years and have outstanding use of Fund resources over 100 percent of quota.

This "prolonged use" of IMF resources by many countries in the region weakens the revolving character of Fund financing and may reduce resources available for other members. Fund resources are intended to be used for temporary balance of payments financing -- not long-term development lending.

Closely related to the problem of prolonged use is the fact that an increasing number of countries in the region have fallen into arrears to the Fund. Seven Sub-Saharan countries are currently in arrears for a total of SDR 320 million, and arrears have grown rapidly. Under current rules, countries in arrears may not draw IMF resources under existing programs nor negotiate new ones. In the case of persistent arrears (nine months or more), a member may be declared ineligible to use IMF resources, a first step toward possible expulsion.

Continuation of such a situation represents a serious problem for both the countries and the IMF. We must address this problem and come up with a solution which preserves the financial integrity of the IMF while being realistic about the ability of the countries to improve their economic situation, restore their creditworthiness, and meet their financial obligations.

A New Approach

Despite expanded efforts by the IMF, MDBs, and bilateral donors to assist the Sub-Saharan countries' reform efforts, economic recovery remains as elusive as ever. This failure in part reflects inadequate action by the countries on the fundamental changes needed to create the conditions for sustained growth and development. It also springs from adverse external developments, especially depressed prices for the commodities which are the region's principal exports, and natural disasters which have afflicted the region.

Finally, the lack of success arises from the fact that the economic problems of the poorest countries require comprehensive reform extending over the longer term that would encompass both the types of structural changes supported primarily by the World Bank and sound macroeconomic policies which are the heart of IMF

programs. The individual efforts of the IMF, the MDBs, and bilateral donors, even though sound on their own terms, have not produced this comprehensive result.

A new formula is needed to address the region's economic problems, based on closer coordination between the IMF and the MDBs, and supported by bilateral official assistance. The $2.7 billion of repayments flowing back to the IMF Trust Fund through 1991 provides a unique opportunity to launch such a comprehensive economic reform effort for Africa. In a period of tight financial constraints, we cannot afford to waste these scarce resources. It is essential that they be targetted to help those most in need, and to lay the groundwork for future growth.

The United States therefore proposed at the IMF Interim Committee's October 6 meeting in Seoul that these reflows be used to provide concessional financing in support of comprehensive economic reform for the poorest countries with protracted balance of payments problems, primarily in Sub-Saharan Africa. Under the U.S. proposal:

- Eligibility would be based on low per capita income. Actual use of funds, however, would be based on an eligible country having a protracted balance of payments problem and being willing to implement a comprehensive growth-oriented economic program.

- Terms on loans would be concessional with low interest rates, substantial grace periods, and extended maturities.

- Conditions for participation would include a commitment to a multi-year growth-oriented economic program in which funds would be disbursed semi-annually based on satisfactory performance under the program.

This approach would seek to remove structural impediments to production, savings, investment and non-inflationary growth. To accomplish these objectives, each program would have to include both macro-economic and structural components, tailored to individual country needs.

- Macroeconomic policies would aim to provide a stable domestic policy environment for longer term restructuring and growth. They would continue to include sound monetary and fiscal policies to reduce domestic imbalances and inflation, as well as free market prices and exchange rates to encourage production and more efficient use of resources.

- Structural measures should reduce the role of government, give greater scope to private initiative, and provide stimulus to domestic growth. They would include efforts to privatize the public sector, improve the efficiency of state-owned enterprises, and reduce government intervention in the

economy. Growth-oriented tax reform and interest rates designed to stimulate savings and domestic investment should also be adopted.

- Finally, trade liberalization and investment promotion measures to make foreign direct investment more attractive would be critical to bring in the resources needed to boost both growth and exports.

While utilization of Trust Fund resources would be the responsibility of the IMF, it would be absolutely critical that the Fund operate in close cooperation with the World Bank to achieve a consistent policy approach that would help these countries in creating the fundamental conditions for growth.

Other participants in the Seoul meeting clearly shared our desire to accord priority attention to the problems of the poorest countries. Consequently, the Interim Committee endorsed the U.S. view that Trust Fund reflows should be used to provide concessional balance of payments support for low-income countries implementing comprehensive economic programs. There was also a consensus on the importance of close Fund/Bank cooperation.

The United States is also prepared to consider an even bolder approach involving joint IMF and World Bank programs and financing to foster adjustment and catalyze additional financing for these poorest countries. We believe that such an approach would have a number of important benefits.

- Joint programming would ensure close coordination of IMF and World Bank assistance for the poorest countries, and encourage closer cooperation between the institutions in general.

- The comprehensive nature of the programs would ensure that the institutions provide mutually consistent advice on the full range of macroeconomic policies and structural reforms necessary to attack poverty and promote growth.

- A joint approach could catalyze substantial additional resources for Sub-Saharan countries to support economic reform.

We noted in Seoul that we were prepared to consider seeking resources in support of such an approach if other donors were also prepared to make equitable contributions.

However, a number of countries seem to be concerned about the concept of joint IMF/World Bank programming. New ideas are rarely accepted overnight. And there has been some understandable reluctance to move into the uncharted waters of comprehensive programs which would unify the efforts of the two institutions.

Despite these concerns, I believe it is worth the effort to ensure that the IMF and World Bank are pulling in the same

direction, in the most effective manner possible. Joint programs, based on consistent policy advice and coordinated financial support, would be more effective, especially if they mobilize additional resources for reform. We are hopeful that others will recognize the merit of this approach, and we would hope for final agreement on it by the end of the year.

Whichever route is taken -- continued separate programs with closer coordination between Fund and Bank, or a bolder joint program approach -- we will attempt to ensure that the Trust Fund reflows are targetted to help the poorest countries, and their use based upon the adoption of macroeconomic and structural policy reforms which will improve prospects for sustained economic growth in Sub-Saharan Africa.

Conclusions

In conclusion, it is clear that additional efforts are needed to address the economic problems of Sub-Saharan Africa. Secretary Baker's proposals in Seoul have made a major step in this direction, and provide a basis for discussion of further, bolder steps in the future. They have gained the broad support of the global community.

I welcome the opportunity to discuss these ideas with you, and to answer your questions on our approach to aiding the poorest countries.

Thank you.

Senator KASSEBAUM. Thank you very much.

We appreciate the comments that you both have made.

I would like to ask first just how realistic the new ideas are—and I would say perhaps it was more of a reemphasis that was put forward at Seoul—regarding most of the sub-Saharan African countries. It seems to me we have seen various countries that have attempted and are attempting to meet the guidelines that IMF has put forward and that have been put forward by others on economic reform, and these countries have taken some austere measures which can only be pressed so far, and have suffered some turmoil within because of these changes.

How realistic is it to assume that we are going to see any major changes?

Mr. MULFORD. Well, if I could expand on that just a bit in answer to your question. The IMF programs that were used earlier have not been adequate, as I have said in my testimony, because they are Balance-of-Payments Oriented Programs of short-term duration with limited objectives. As you point out, in some cases they have resolved in a rather heavy dose of austerity.

What is needed in Africa are two things, I think: Comprehensive policy reform and more resources to carry out an adjustment effort that lays the basis for growth in many of these countries.

The conclusion that we came to in working out this proposal is that it is really now evident that the longer term structural problems that these countries face can best be addressed by a comprehensive approach involving both the World Bank and the Fund. And so, our attention went to try to find a way to bring these two institutions closer together so that a more realistic—perhaps one

could call it new—set of policy guidelines could be developed for these very special cases of the very poor countries which we see in Africa. So you would not be looking at just an extention of traditional IMF Programs, nor just a project lending approach, as usually pursued by the World Bank, but a more comprehensive approach produced by the two institutions working together.

In connection with that, the plan calls for a substantial increase in the resources that can be brought to bear on these countries. One source would be the Trust Fund resources, which we know are $2.7 billion, flowing back between 1986 and 1991. But under our plan, we had hoped to draw additional resources of approximately equal size from the World Bank side of the equation to focus on these countries.

This combination of funds, together with a new approach specially designed to recognize the long-term adjustment process that has to take place, we feel is a step that is very significant and will have beneficial results if it can be implemented.

Senator KASSEBAUM. Do you mean the coordination and longer term adjustment?

Mr. MULFORD. It's a little more than coordination. We have in mind that the Fund and the Bank would actually approach these countries with joint teams and joint programs, that would be drawn up, negotiated with the countries implemented and monitored on a joint basis. So it would be more than just coordination. It would be a fairly comprehensive, coordinated approach.

Senator KASSEBAUM. Weren't there some questions raised about that, though, at Seoul and elsewhere? What is the downside to that that has been expressed?

Mr. MULFORD. Well, what we found among some of the major industrial countries when we discussed the issue with them at meetings prior to the opening of the Bank meeting was a concern about some of the implications of the two institutions working together. This I think is natural.

We found that there was a misunderstanding, which was partly our fault, arising from use of the term "joint facility." I think, in retrospect, this was the wrong term to use, because the conclusion that others reached was that we were actually proposing to form some new bureaucracy or physical organization between the two organizations, and there was a lot of opposition to the idea of creating yet another bureaucracy.

We did not have that in mind. We used the term "joint facility" in a financial sense and not in an organizational sense at all.

I think that some people have begun to rethink their positions as they have come to understand that we do not have in mind merging the two organizations or creating a special offshoot with its separate staff, bureaucracy, and so on.

And then there is the question of cross conditionality, which is a sensitive issue for the African countries because they are worried about linking too closely the conditionality between the two organizations. They want to keep separate the present conditionality that exists in both organizations—Fund programs on the one hand and project loans on the other in the World Bank. What we have in mind is the development of a special, new approach to their problems that would be, on the one hand, concessional, but would also

pay attention to the necessary policy changes that have to take place.

So it is not a question of just locking both conditionalities together. It is a question of developing a new approach specifically designed for these countries.

Senator KASSEBAUM. Mr. Whitehead, you mentioned that Zaire, for instance, had to spend 60 percent of its budget on debt service, and that this was approximately true for a number of countries.

Do either of you think that there would be some merit to recognizing that this is probably going to be extremely difficult to repay, and considering some effort to forgive a certain percentage, or turn it into grant aid?

Mr. WHITEHEAD. As a former banker, forgiveness is a word that I do not like at all. Although I recognize the tremendously heavy burden that these historical debts do impose on these very fragile economies, I do not believe the course of action is forgiveness, but some recognition of decreasing the burden of repayment and decreasing the burden of interest payments is certainly in order, because no country can survive successfully when more than half of its Federal budget needs to go to service its historical debts.

That would not even be possible for a country as strong as the United States, which, itself, is going to reach that position if it is not careful.

Senator KASSEBAUM. When you say decrease, would you consider changing some of that into a grant?

Mr. WHITEHEAD. Not the historical debt. I think the historical debt must stay on the books and that the target must continue to be to eventually pay back those past loans.

Additional financing that is provided can take a variety of forms, and I would hope now, with the new creative thinking that is being used, that we will consider the possibility of grants as well as lending, that we will also consider the desirability of private sector investment, that we will consider a whole variety of ways of raising new money to permit Africa to begin growing again.

If I might make just a further comment to Mr. Mulford's answer to your previous question, I believe we have been through what we might call phase 1 of development bank assistance to Africa, a phase which has been characterized particularly by the participation of the IMF. And, while it is popular these days to criticize the IMF for having imposed too harsh restrictions on some of these economies, restrictions which politically they are not able to handle, I would be much more complimentary of the IMF's role in the last several years than that because I believe they have caused these countries to face up to the realities of their economic programs and to adopt in many cases sensible economic measures which give the countries some hope of survivability, which they really did not have prior to the IMF's presence.

So I believe this IMF phase, phase 1, has been a desirable and constructive and necessary phase. But, in and of itself, it is not enough. Just placing restrictions and bringing back sound economic policies is, on its own, not enough. The IMF does not have the resources to provide the growth funds.

So now we are beginning to enter, I think, phase 2, in Africa, and the kinds of programs that have been outlined at Seoul and

are now being worked on in the administration do represent a new phase, where the IMF restraints will continue to be enforced and will continue to be a factor. But additional new funds, with the World Bank's assistance and, hopefully, with donations from other developed countries of substantial amounts will provide the growth funds and vehicles to bring back some kind of growth prospect.

It is only through growth, only through economic growth, that Africa will ever be able to provide the funds to service its past debts and to permit its economies to continue to develop and to permit its standards of living to turn around and once again to begin to increase.

Senator KASSEBAUM. That is true. But, as you pointed out, declining agricultural production and declining world prices for agricultural products are going to weigh heavily in that. It seems to me, and I would agree, that discipline is very important. I think Nigeria is a good case of everything seeming to go askew—Government policy and outrageous capital outflow, with seemingly no control or thought given to an orderly process.

I do not even know if we have any IMF loans to Nigeria at this point.

Mr. MULFORD. There are none. There has been substantial World Bank lending to Nigeria, but the IMF has not been able to establish a standby program with Nigeria up until this point.

Senator KASSEBAUM. Is this contemplated, or has Nigeria simply not been able to meet the guidelines?

Mr. MULFORD. The chief issue in Nigeria's case has been, first of all, their unwillingness to undertake the kind of policy reforms that are necessary to reach a standby agreement. Chiefly the question that has deterred this has been the devaluation of their currency, which is regarded by the Fund as essential to any successful standby program.

But also, Nigeria, as you know, is a country which has had very substantial oil revenues, and because it had large reserves had not felt quite the pressure to reach agreement with the Fund in recent years that some other countries have. That is changing now. Their reserves are down to a very small amount, they have a new Government, and they are reviewing their situation to see what their stance will be.

Senator KASSEBAUM. I would just like to ask one other question.

There are those who say we should be looking at concepts that are a little more creative in how we deal with the debt crisis. One suggestion by Mr. Wesson of the Hoover Institution is that a revolving fund be established, whereby the money owed could be returned to the country for use in capital development, rather than just going back to the lender for debt repayment, based on the idea that believing this is a more productive use of that money.

Mr. Whitehead, as a banker, how would you view that?

Mr. WHITEHEAD. Again, I quite agree that new, creative solutions, all of them, should be considered, including the specific one that you have mentioned. And I think we have to distinguish between creative solutions that involve private sector lenders and creative solutions that involve Government lenders.

I think private sector lenders who have loaned money to these countries must make their own decisions as to how they are going

to use the interest payments that they get back, whether they will pocket the entire interest payments or allow the countries to plow back some of these interest payments into new developments.

I would be in favor of the latter. I would think myself that that would be in the interest of the lending institutions, to concede that the way toward eventually getting their loans back would be to make some concessions about how the interest payments would be reinvested.

So I have a general sympathy toward that Hoover Institution suggestion.

But the revolving fund idea I think is a good one and merits consideration.

Senator KASSEBAUM. Thank you.

Senator Kerry, we have a vote on. I am going to leave to vote, and will come right back in time for you to leave to vote.

Senator KERRY. So that I can vote.

Senator KASSEBAUM. Yes.

Senator KERRY [presiding]. Thank you very much. I will count on you.

Under your proposal the World Bank is going to rechannel some of its project lending back into this program, and I gather you are looking to other donor countries to do the same thing, a sort of deprojectization, or whatever you call it.

Do you have assurances that they are willing to do that? Is that something you know people are doing?

Mr. WHITEHEAD. No, not as yet, because the idea was only launched at Seoul a couple of weeks ago. But the very initial indications show interest.

David was there and I was not, so he maybe could comment more specifically.

But I would point out that two European countries, France and Britain, have very substantial historical interests in Africa that give them a special responsibility in Africa, more than maybe even the United States might feel. We are trying to get those two countries, along with others, to recognize those special responsibilities—the historical ties and commercial interests that they continue to have with Africa—by providing their fair share into this new fund.

We also feel that Japan should be concerned with the problems of Africa, as it should be with the problems of developing countries around the world, possibly to a greater extent than they have, and I think we have some indication that at least some people in Japan feel that that great and very prosperous country might make its significant contribution.

So those are three countries to whom we would look for very substantial support.

In general, you will note that our testimony this morning did not make any plea for Government funds. We have no request before you to provide taxpayer money for this program. We may have in the future, but we are trying to find money elsewhere before we look to Congress to provide funds from the budget.

There are other sources.

Senator KERRY. Which sources would you look to most?

Mr. WHITEHEAD. Well, most, of course, we would look to the IMF and the World Bank, as we have described. We start, of course,

with the IMF Trust Fund sources, as our testimony indicated, and to enlarged and enhanced World Bank lending, and then to other nations for contributions; and only last of all, as a last resort, will we plan to come to Congress and ask for additional U.S. funds.

It is a significant part of this plan. We are trying to provide as much money as we possibly can to help Africa develop with the very minimum amount of U.S. taxpayer contribution, an objective which I think all of us would easily agree is a desirable one if it can be achieved.

Senator KERRY. I have a few more questions, but I know the administration wants me recorded on this vote.

Senator KASSEBAUM [presiding]. It's a motion to instruct.

Senator KERRY. A motion to instruct—nobody wants to be recorded on that. [Laughter.]

Senator KASSEBAUM. I would have just one more question.

Senator Kerry, are you coming back?

Senator KERRY. Yes, I am.

Senator KASSEBAUM. Fine.

This is addressed to you, Mr. Mulford.

Secretary Baker, yesterday, when he was testifying, mentioned the case-by-case approach. While I think this is very important, I wonder if you could give an example of an African country where you see this change in emphasis being useful and productive, as you would analyze it, perhaps in combination with the State Department's economic policy initiative. I assume that the two go together.

Mr. MULFORD. I was not at yesterday's hearing, but Secretary Baker's main comments were on the debt strategy in general, where a case-by-case approach is indicated as the basis on which we plan to continue proceeding with the management of the debt problem.

The Trust Fund proposal is a different proposal than the debt initiative, which he announced in his speech. They are really separate ideas. The Trust Fund proposal, which I outlined earlier, is aimed at the poorest countries, most of which are in Africa, and they are different from the major debtor countries, as we use that term, because they are not heavy users of commercial bank money.

Senator KASSEBAUM. So his case-by-case approach was for the heavy debtors?

Mr. MULFORD. Well, no. The case-by-case would also apply to the Trust Fund's operation, if that were to be set up, because each country is different and has to be handled differently. That is really all that means.

It is used to distinguish between a case-by-case approach on the one hand versus a comprehensive solution to the problem on the other, which is a solution one would think up which applies to all countries. We happen to think that a general approach is not possible because countries are different from one another politically and economically. They are also at different points in their adjustment process, and they have different needs. Therefore, a case-by-case approach is really necessary both in the Trust Fund approach and in the debt strategy initiative the Secretary made in Seoul.

Mr. WHITEHEAD. If I might just add a word to that, I, too, am a strong advocate of the case-by-case approach because each country

is different and each country must make its own decisions and has its own economic policies. However, when it comes to additional money for growth, I think more thought has to be given than has been given in the past to sort of regional solutions to the problems.

When the additional funds are supplied, they need to be supplied in a way that will benefit not only individual countries, one by one, but also the region as a whole, with some better coordination over the use of the growth funds than possibly has been true in the past. Because of the independence of these many African nations, their economies have, in a sense, become very fragmented. Each country, many little tiny countries, have their own economies, and their economic problems are comparable to those of their neighbors.

So when we advance additional funds, we need to coordinate the use of those funds so that it contributes not only to a country-by-country progress but also to a regional progress.

Senator KASSEBAUM. Well, let's take Zambia. Case-by-case is something that we have been doing to a certain extent. I don't know about the large debt structure of the major debtor countries, such as Brazil. But Zambia is a good example of a country that has tried and I think, been relatively successful in meeting some of the requirements. It has been a recipient, I believe, of EPI funds. And yet, it is still struggling and having real problems even though they are making internal reforms and have a fairly stable political structure.

In the opinion of both of you, what could or should be done to help Zambia through the impasse that it faces, with declining copper prices, and obviously the copper industry is not going to come back any time soon? If this is a case-by-case approach, I would like to hear a little bit about how you would analyze the case of Zambia.

Mr. MULFORD. It is hard for me to sit at this table and prescribe what a country should do. But I do think, to be absolutely forthright about it and having myself had some experience in Africa some years ago and having followed it very closely ever since, there have been, in the African case, some very poor policies pursued for very many years, which have had a very deleterious effect on those countries and on those economies.

Zambia nationalized copper production, nationalized the banks, and did a number of other things over the years which chased away private capital, for example.

They are still recovering from those kinds of moves.

I remember in the mid-1970's, when I was in Saudi Arabia, lending money to various places and following other countries that we were in close touch with. Sudan at that time was regarded as the future breadbasket of the whole of the Middle East because it was agriculturally rich. It also had some promise of oil at that time. Yet, it followed policies designed to drive farmers out of business, by putting price restrictions and subsidies on the farm sector. This had the reverse effect that was desired—not to develop agriculture, but to discourage it.

They are suffering from these effects today.

These are the kinds of long-term policies that have to be looked at, and great changes have to be made by these governments in approaching these problems.

Now, the longer they go along with subsidies, for example, which widen the difference between local prices for a product and world prices, the more difficult it is politically to make the changes that bring those prices back into line, because, if they raise the price of bread, sugar, or whatever it happens to be, then there are a lot of political problems, such as riots in the streets and so on.

That gets translated into a political result that matters very much to us. But we must not lose sight of the fact that those are the left-over debris of previous policies. And when we talk about long-term structural change, and the Fund, and the World Bank, and our own Government, we have in mind encouraging them to try to bring these policies back into a realistic balance so that they can command more resources and they can use better the resources which they have—whether they are from the Fund, the Bank, the AID programs of the United States or other donor countries.

Senator KASSEBAUM. Thank you.

Senator Kerry.

Senator KERRY. Thank you.

The administration, I believe, was opposing a similar debt relief concept last year, believing instead that we should have increased bilateral efforts to relieve the problem. Now there has been a shift.

I wonder if you might describe what caused the administration to come around. What is the thinking there?

Mr. WHITEHEAD. I cannot answer that. I am new down here.

Mr. MULFORD. I will have a shot at it.

Are you referring to the sub-Saharan African Program that we did not participate in?

Senator KERRY. Yes.

Mr. MULFORD. Well, first of all, we have participated in IDA, and we have made a substantial contribution and are continuing to make a contribution to IDA. Then, within IDA, it has been our policy to encourage a larger proportion of those funds to flow to Africa.

When the other initiative came along, the sub-Saharan one, it was, to be frank about it, an initiative based on the view in some quarters that we should have done a bigger IDA VII, and that in order to get us back up to where we should have been on an IDA VII, we really ought to do this special program.

We did not agree with that approach.

Our approach was to do a reasonable IDA and to try to encourage a higher proportion of IDA funds to flow to Africa.

Then we also felt, and I think it is clearly demonstrable, that we were doing a very substantial bilateral aid program for Africa. Emergency food and regular aid, totaling in the past fiscal year $1.7 billion, which really did not make it necessary for us to participate in that program.

We still have that view.

There is a major difference, I think, in the Trust Fund approach, which I would explain to clarify your question.

The $2.7 billion on the IMF side are funds that are coming back as repayments from a previous facility that was setup. Those funds

were lent, initially, with absolutely no conditionality whatsoever, and the thought has been, and I think it is widely agreed, that there should be some better direction of those funds when they go back out again. That is the first point.

The second point is that if the Trust Funds were lent in the same proportions that they were the first time, it would mean that a very small amount of the Trust Funds would go to the really poor countries because there are other low-per-capita income countries that are big takers of those funds, chiefly India and China.

So the Trust Fund proposal is designed to have an eligibility arrangement which changes the flow of those funds and skews them so that there is much more of the $2.7 billion going to the poorest countries. This would be achieved by requiring that countries which are eligible have both a low-per-capita income level and also a protracted balance-of-payments need as the conditions for its use.

In the cases of China and India—and I think we should recognize this; I think we should pay them respect for their decisions in Seoul—they indicated that they would forgo the use of those funds.

So, here you have the $2.7 billion, capable of a much greater concentration on the poor countries, so there is real additionality of money there, which would encourage them, in order to get a lot more money than they got the first time around, to begin to undertake some of the tough policy decisions they have to take to get what will still be concessional money, but will have some measure of policy content in it.

Then the idea was to add the money from the World Bank side, which we thought would be an equivalent amount, making a total of $5 to $6 billion, to make a really significant pool, directed chiefly at the poor countries.

Now, that is a lot bigger over the period 1986 to 1991 than the strictly sub-Saharan African fund, which I think is $1.2 billion spread over 3 years. Also, we think that the plan to effect a better joint approach between the Fund and the Bank, which the sub-Saharan African fund does not do, is absolutely essential to the ultimate solution of this problem—given the fact that a lot of these countries are already in the Fund.

Senator KERRY. During the past few years, I think it was in 1984, a number of IMF officials despaired over the ability of the IMF effort to leverage the kinds of changes that they were looking for, specifically, the alteration in monetary and fiscal policies and so on.

Given the magnitude of this debt crisis, given the amount of money and the probable, I would think, willingness of everybody to admit that this really is not adequate, why is it going to leverage it suddenly? What is the difference here? Why is this process suddenly going to result in the changes that we have not been able to achieve in the past?

Mr. MULFORD. Well, the situation in Africa differed from that of the major debtors. When the Fund did a standby program in the big debtor countries who accept Fund conditionality, it provided, in a sense, a "Good Housekeeping Seal of Approval" that unlocks vast resources from the banking systems for countries like Brazil and Argentina. In Africa, as I said before, there is not a lot of commercial bank money involved. Apart from the IMF, most of the other

money in aid flows from a wide variety of donor countries and also MDB flows.

I think the Fund has found that it does not have the same leverage, in a sense, over the additional official flows that it does with regard to the commercial banks and the big debtors, because a lot of aid flows have been made, unfortunately, purely on the basis of political relationships, with no knowledge or attempt to look at underlying policy reform.

Some countries in Europe simply pump aid into certain African countries without any sort of requirements at all, and this simply exacerbates an already bad situation. It does not help with reform.

That is why we think it essential that the Fund and the Bank cooperate more closely. Greater resources can be brought to bear from those two organizations on the problem. Also, there is a growing awareness, I think, on the part of governments, our own as well as others, that policy reform is an absolute necessity, otherwise the aid is wasted. So, this time around you might get better donor coordination, together with better IMF and World Bank coordination, and, while it is a tough job, you might be able to develop, in a sense, a new—I don't like to use the word conditionality—a new set of policy reforms that are specifically aimed at the very long-term structural adjustments that these countries have to make. I mean not so short term and balance-of-payments oriented as the Fund, and not just project by project lending without an understanding of the comprehensive need for policy reform that goes on sometimes in World Bank project lending.

Senator KERRY. Can you be successful without the other donor cooperation?

Mr. MULFORD. Well, it is difficult, but I think there is a greater awareness of this need today among donors. I would not say it is perfect. Even in our own Government, we sometimes do things that are not linked to needed policy reform. We do it for other reasons, perfectly good reasons, in some cases.

But we must not forget that, when that happens, we are not contributing to the long-term economic performance of the country.

Senator KERRY. That raises a question that I really wanted to ask of Mr. Whitehead, which is this. How would you describe the goals and what drives our policy now with respect to sub-Saharan African policy? What do we hope to achieve?

Mr. WHITEHEAD. Our basic goals are to maintain political stability in Africa. It is in our country's interest to do that.

Our second goal is a humanitarian one, to prevent starvation and poverty from becoming worse in that country, as there is no area of the world where poverty is worse and starvation is more rampant.

So I would suppose that those are the two basic principles that drive our policy there. It is the maintenance of political stability and the humanitarian desire to improve the lot of that tragic part of the world.

Senator KERRY. Given that, and given the fact that I gather total debt of African countries is something like 10 percent of a developing nation debt in the world, is it possible that this is, on its face, not enough, that that debt ought to be higher, given the level of problems that currently exist? Would you say on its face that this is an adequate policy to meet those two goals?

Mr. WHITEHEAD. I cannot say that this is an adequate policy yet to meet those two goals. But what we are proposing or beginning to propose is a giant step forward from where we are today. Whether it is enough to achieve success I think is a very good question, and I cannot answer that positively.

But it is a major step forward. We are talking about more than doubling the annual amount of money that would flow from the developed world to Africa on an annual basis. That is a major change.

I think it goes from hopelessness to possible success by doing that. And so I think it is a step that is very desirable to take. But this is a terribly difficult part of the world, and whether it is enough, I cannot say.

Senator KERRY. I suppose what I am really getting is the question, it seems to me, that they are so closely intertwined that if the humanitarian effort fails, I suspect the other probably would be more prone to failure.

Given what Mr. Brown said earlier about the resource based approach—and you are familiar with that—I wonder if you have other thoughts as to what we might be doing or wherever, for instance, there is an ability to broaden the donor base, whether there is an ability to deal with the resource base problem that does not mandate leveraging these other changes and is not as tied to it in a way that may make those easier ultimately.

Mr. WHITEHEAD. David, do you have any thoughts on that?

Mr. MULFORD. Well, broadening the donor base is a very difficult enterprise because more and more donors see that, unless policy reform is effected, their flows will simply leave as capital flight.

There is a shortage of capital in this part of the world, and placement of capital is hard to dictate to the private sector—impossible, really. And among governments, there is a real reluctance—take, for example, in Sudan—to broaden the donor group and enhance donor flows at this moment to Sudan because there is not confidence that they are going to put into place the right package of economic policies to insure that those new flows of funds are effectively put to use in that country.

Senator KERRY. What I am getting at is whether or not there are ways outside of the dilemma of a government to waste it or lose it or to build 747 airstrips near the home of an emperor, those kinds of things, is there an ability to do things that result in the planting of trees, that will deal with soil conservation, that will mobilize other kinds of resource efforts that may ultimately strengthen the infrastructure so that you bring the political change along behind with it?

I don't know. I am just wondering here.

Mr. WHITEHEAD. Yes, I think there is. I think that better coordination between IMF restraints and the World Bank long-range economic advice, all of those things contribute to just the kinds of things that you are talking about.

One thing that I would mention which it seems to me is not included in the testimony but is significant is this. You notice a much more forthcoming attitude from the administration in Secretary Baker's speech about the role of the World Bank than has

been the attitude of the administration previously. I think that this is very significant.

He made no promises about U.S. support of capital increases. But he certainly indicated that he is looking to the World Bank for a much broader role.

Previously, the administration has not been entirely supportive of the World Bank and its efforts.

The World Bank is the broadest based organization of international support for projects. All nations, I guess, except those in the Soviet Bloc, belong to it and are members of it.

So, when the World Bank makes a loan, it is, in effect, a loan from a great many nations all over the world. So, when the World Bank is involved, it is a very broad base of support. When the World Bank steps up its lending to Africa, it is a recognition by the whole world that it cares about the problems of Africa.

Senator KERRY. Thank you.

Senator KASSEBAUM. Thank you very much.

We appreciate your being here today.

[A brief recess was taken.]

Senator KASSEBAUM. It is a pleasure to welcome the next panel.

I feel very fortunate in having four people who have great interest and depth of knowledge in the subject we are talking about today.

The panelists, beginning at my left, are Mr. William Dale, past Deputy Director of the International Monetary Fund; Mr. Niles Helmboldt, president of Equator Holdings, Ltd; Richard Moose of Shearson Lehman Bros., Inc., and former Assistant Secretary of State for African Affairs; and Robert Wesson of the Hoover Institution.

Mr. Dale, why don't we start with you? We look forward to any comments that you might wish to make.

STATEMENT OF WILLIAM B. DALE, PAST DEPUTY DIRECTOR, INTERNATIONAL MONETARY FUND

Mr. DALE. Thank you, Senator.

I have not prepared an opening statement and only want to say that I broadly agree with what the administration has put forward this morning. I find nothing to disagree with in a large way regarding the testimony given by either of the administration witnesses.

I do very strongly agree with the view that the foundation of what should be done in this very difficult situation in Africa must rest on policy reform of a very fundamental sort. For this reason, the approach, I think, must very largely, although not wholly, be on a country-by-country basis.

Beyond that, you will perhaps forgive me if I simply say that there was a slight difference, I thought, in what Mr. Mulford and Mr. Whitehead respectively had to say about the success of the IMF a few years ago in Africa, and naturally I agree with what Mr. Whitehead had to say.

Thank you.

Senator KASSEBAUM. Thank you.

I hope, after everybody has made opening comments, we will feel free to exchange views.

Mr. Helmboldt, would you go next, please?

STATEMENT OF NILES E. HELMBOLDT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, EQUATOR HOLDINGS, LTD.

Mr. HELMBOLDT. Madam Chairwoman, thank you.

Following Mr. Dale, I will present a few opening remarks. Although they will be abbreviated, I have submitted a formal paper, which I believe is already here today. I would like to thank you very much for the opportunity to testify here this morning.

A major question really is whether Secretary Baker's proposal will ease the economic crisis or merely apply bandages while the African economies continue to bleed themselves dry.

The corollary question is whether these economies are already beyond help; whether anything is changing in Africa that may offer the chance for successful rehabilitation.

My answer on the first point is that today, even the bandages are urgently needed.

The United States and the rest of the free market economies—and I include in that the world banking community—can do much to help stanch the flow of vitality out of Africa's economies. There is still much of value there; still much that is worth saving.

Without some bandages, much more will still be lost.

If we will act today to stave off collapse, the African economies will be that much more intact, as the long-term solutions become available and viable. Politically, socially, and economically, it is much better to save what is still left to be saved than to abandon Africa in the interim and let it pay the price in wasted lives.

I am not here, though, to belabor the obvious. My answer on the second point is that what we see in Africa today can make us somewhat optimistic.

The basis of our hope—that of my colleagues and me—for Africa is that, certain conditions notwithstanding—the drought, the sharp deterioration in terms of trade during the recent worldwide recession—Africa's economic crisis arises out of political leaders' mistakes in policy. It, therefore, follows that if the mistakes are corrected, economic progress can resume.

Even in countries verging on economic collapse, where the assistance provided under the Baker proposals is most urgently needed, we are seeing changes that already offer hope for Africa.

Things are definitely happening, things that can lead to successful rehabilitation, given African perseverence and some outside support.

I would like to emphasize, as I always do when given the opportunity, that the changes must come from Africans themselves, and, indeed, this is where the changes are coming from today. This is because side by side with a desperate need, there certainly is a new practicality. With the assistance contemplated under the Baker proposals, this new practicality should be encouraged and nurtured until it takes hold and breathes some new energy into economic life.

What we see as most encouraging in Africa is that, in contrast to a heavy and oppressive government concern with economic development, there is now a new indication of individual initiative in

economic matters and affairs. I believe personally that this is very healthy. It should receive support by any immediate, remedial support that we can give.

We are already seeing corrective decisions in Africa. You mentioned before, Madam Chairwoman, Zambia. I certainly should point out that President Kaunda, years ago, nationalized the country's copper industry, which is the economic base, and then used these revenues to establish and support a large number of uneconomical state enterprises, providing virtually all of the goods and services available to the Zambian people.

The world demand for copper has fallen, the prognosis for copper prices going forward is very bleak, and the outflow of cash in Zambia to provide the basic food and fuel requirements of the country and other basics has resulted in that country's debt rising to $2.6 billion, in U.S. dollars, or about $400 United States per Zambian.

Despite several IMF programs and a rescheduling of the debt on two separate occasions, Zambia's finances are in extremis today.

But I am optimistic, and I see encouraging signs in Zambia because President Kaunda recognizes the results of his earlier policies and the nation's policies, and he is moving to correct them.

For example, instead of funneling all of the hard currency earnings of the country directly into the national treasury, the government now allows the copper industry to retain 35 percent of its export earnings, and they are being used to reequip and rehabilitate the Zambian mines and the smelters and the transportation facilities connected with the mining industry.

The country actively welcomes foreign investors, especially in agriculture and industry. In fact, there are major U.S. agricultural initiatives in Zambia now, which are being widely welcomed and supported in that country. Also, domestic exporters are now allowed to keep half of their foreign currency earnings for the purchase of equipment and raw materials to further their individual enterprises.

During the past year, the government has allowed grain prices to rise to market levels. Farmers are now getting a realistic return on their investment and labor, and the results this year, together with some luck in rainfall, has been a bumper crop of maize.

This is a welcome development.

When I was in Seoul 2 weeks ago for the IMF-World Bank meetings, I certainly heard, as I am sure all who were there did, some skepticism about Secretary Baker's proposals raised by the world's commercial bankers who, certainly, will be reluctant to put additional money into nations on the verge of default.

But, this morning, I would argue that Zambia is a country already struggling to meet Secretary Baker's test for policy reform and willing to go further.

I also would say that my own bank is certainly willing to put new money into Zambia if its reforms continue and if the proposed IMF, World Bank, and American programs help bring its finances back from the brink.

Let me cite another example: Mozambique.

President Samora Machel was here recently. He took to the White House a description of his economic reforms and of the

changes in that country which have moved Mozambique from a complete focus on central planning and a COMECON orientation toward a pragmatic approach, certainly with openings to the West, which now include membership in the IMF and the World Bank.

Having made these changes, President Machel might reasonably expect some American support. I think when he went to the White House, he was looking for indications of some receptivity and some indications of where support might be obtained.

But, we are talking about an economy, Mozambique, in the last stages of collapse. The metaphor comes to mind of someone who is on a life support system. If this were Mozambique, the bells would certainly be ringing because all of the signals are bad.

It calls for immediate, intensive care, a massive infusion of aid.

We are familiar with most of the sub-Saharan African countries at Equator because that is the only place where we do business. We do business in sub-Saharan Africa, not in the Republic of South Africa, and we have done so for about a decade. We know that many other countries, as well, have opted for a pragmatic approach that reduces their Government's economic responsibilities and frees the domestic private sector. That list includes at least half the countries on the continent.

Africa's problems are long term, and the solution will be the work of generations. But the shift in basic policy, which goes well beyond the austerity measures normally exacted under IMF conditionality, gives me more hope than I have had in the recent few years. Africa is choosing practical solutions because its governments have run out of alternatives. There are no radical models left untried, no super powers bidding for their loyalties, and no petrodollars waiting to be recycled.

I personally believe that the United States should encourage these reforms and help them to take hold.

I would like to close by mentioning briefly some of the steps we think we might consider, which could affect reform quickly. I have divided those into some short- and long-term proposals.

Under the short-term category, some immediate assistance in the form of foreign exchange to rehabilitate existing—I emphasize existing—production facilities, especially those with export markets. Africa has dozens and dozens of facilities lying idle today, principally for lack of foreign exchange, which could be revitalized very easily.

We should continue to support our own institutions, such as Eximbank, OPIC, and AID's Bureau for Private Enterprise, that foster American investment, lending, and trade with Africa.

I would like to add some support for the idea of a special ambassador to evidence support for the African private sector and entrepreneurs, who could concentrate on focusing our programs to influence policy change to help build the African private sector.

In the long term, I would like to see us use some American financial aid to help privatize parastatal firms, thus helping African Governments recoup some of their capital costs.

One of the problems in Africa is so much investment is now tied up in inefficient or, indeed, bankrupt parastatals, so that all of this previous investment will be lost unless it can be freed. One way to do this, of course, is to privatize them.

I would like to see a program to insure against exchange rate fluctuations, so that aid, moneys that are now languishing because recipients cannot take the foreign exchange risk, might be put to work.

I would like to see our own private sector help promote the development of African capital markets.

I think as a Government we should increase business education and training and create a Fulbright-Style Program for African business managers, because African business managers are a class of resourceful individuals, skilled in many ways and untrained in many others, who could benefit quickly from some formalized education in organizational skills and management techniques.

Finally, I would like to see us consider the idea of using the import side of the Eximbank, to help U.S. business buy African products, to help U.S. business look for African opportunities. Eximbank might provide pre-export financing of African raw materials and African semi-finished products so that they could be imported into this country.

The most vital thing that Africa needs is a market for its export products. One of the easiest things that we could do to help increase the flow of revenues into Africa would be to find ways to help Africans sell their raw materials and finished goods into the enormous American market.

You can see that at Equator, we are convinced that policy-based assistance from the U.S. Government is urgent and necessary and directly beneficial. The situation is grim and is still deteriorating. Yet the stage is being set for recovery and the unleashing of private energies. I believe that, as the world's largest free market economy, America should take the lead in helping Africans complete this economic revolution.

Thank you.

[Mr. Helmboldt's prepared statement with attachment follows:]

PREPARED STATEMENT OF NILES E. HELMBOLDT

MADAM CHAIRWOMAN, SENATORS, LADIES AND GENTLEMEN: MY NAME IS NILES E. HELMBOLDT. I AM PRESIDENT AND CHIEF EXECUTIVE OFFICER OF EQUATOR HOLDINGS LIMITED, A CLOSELY HELD PRIVATE COMPANY PROVIDING BANKING, EXPORT-IMPORT TRADE, AND MANAGEMENT ADVISORY SERVICES EXCLUSIVELY IN SUB-SAHARAN AFRICA, WITH THE EXCEPTION OF THE REPUBLIC OF SOUTH AFRICA.

AT THE OUTSET I WOULD LIKE TO EXPRESS MY APPRECIATION FOR THE SUBCOMMITTEE'S KIND INVITATION TO TESTIFY TODAY ON THE SUBJECT OF AFRICA'S CURRENT ECONOMIC SITUATION. AS BANKERS AND BUSINESSMEN WHOSE WORK IS CONCENTRATED EXCLUSIVELY ON AFRICA, MY COLLEAGUES AND I HAVE TO WRESTLE EVERY DAY WITH THE ECONOMIC PROBLEMS OF GOVERNMENTS, PARASTATAL COMPANIES, AND PRIVATE AFRICAN ENTREPRENEURS. EQUATOR HAS BEEN OPERATING IN THIS MARKET FOR OVER A DECADE. MANY OF OUR OFFICERS, MYSELF INCLUDED, HAVE BEEN ACTIVE IN AFRICA FOR MORE THAN TWENTY YEARS. WE KNOW THAT THE CONTINENT'S GRADUAL DETERIORATION IN PRODUCTIVITY, FINANCIAL STRENGTH, FISCAL CONTROL, AND RESILIENCE HAS NOW REACHED CRISIS PROPORTIONS.

MADAME CHAIRWOMAN, YOUR STAFF MEMBERS HAVE SUGGESTED THAT I MIGHT ENTER A STATEMENT IN THE RECORD. IN ORDER TO SAVE THE COMMITTEE'S TIME, I HAVE BROUGHT ONE WITH ME FOR THAT PURPOSE.

MY ORAL STATEMENT WILL JUST TOUCH ON A FEW KEY POINTS SO YOU WILL HAVE TIME FOR QUESTIONS.

YOU HAVE INDICATED YOUR CONCERN ABOUT THE REAGAN ADMINISTRATION'S PROPOSALS TO MAKE THE INTERNATIONAL DEBT SITUATION MORE TRACTABLE, AND ALSO TO HELP THE POOREST NATIONS OF THE DEVELOPING WORLD, MOST OF WHICH ARE LOCATED IN AFRICA, MANAGE THEIR DEBT BURDEN AND RESUME ECONOMIC DEVELOPMENT AS SOON AS POSSIBLE.

A MAJOR QUESTION TODAY IS WHETHER TREASURY SECRETARY BAKER'S PROPOSALS WILL ACTUALLY END THE CRISIS OR MERELY APPLY BAND-AIDS WHILE AFRICAN ECONOMIES CONTINUE TO BLEED THEMSELVES DRY. THE COROLLARY QUESTION IS WHETHER THESE ECONOMIES ARE ALREADY BEYOND HELP--WHETHER ANYTHING IS CHANGING IN AFRICA THAT MAY OFFER A CHANCE FOR SUCCESSFUL REHABILITATION.

MY ANSWER ON THE FIRST POINT IS THAT TODAY EVEN THE BAND-AIDS ARE URGENTLY NEEDED. THE UNITED STATES AND THE REST OF THE FREE MARKET ECONOMIES, INCLUDING THE WORLD'S BANKERS, CAN DO MUCH TO HELP STANCH THE FLOW OF VITALITY OUT OF AFRICA'S ECONOMIES. THERE IS MUCH OF VALUE THERE, MUCH THAT IS WORTH SAVING. WITHOUT SOME BAND-AIDS, MUCH WILL STILL BE LOST. IF WE WILL ACT TODAY TO STAVE OFF COLLAPSE, AFRICA'S ECONOMIES WILL BE THAT MUCH MORE INTACT WHEN THE LONG TERM SOLUTIONS BECOME AVAILABLE. POLITICALLY, SOCIALLY, AND ECONOMICALLY IT IS MUCH BETTER TO SAVE

WHAT CAN BE SAVED THAN TO ABANDON AFRICA AND LET IT PAY THE PRICE IN WASTED LIVES.

HOWEVER, I AM NOT HERE TO BELABOR THE OBVIOUS, NOR TO MAKE DIRE PROPHECIES. MY ANSWER ON THE SECOND POINT IS THAT WHAT WE SEE IN AFRICA TODAY MAKES US OPTIMISTIC. THE BASIS OF OUR HOPE FOR AFRICA IS THAT, CERTAIN OUTSIDE CONDITIONS NOTWITHSTANDING--THE RECENT DROUGHT, AND THE SHARP DETERIORATION IN TERMS OF TRADE DURING THE RECENT WORLDWIDE RECESSION--AFRICA'S ECONOMIC CRISIS ARISES OUT OF POLITICAL LEADERS' MISTAKES IN POLICY. IT FOLLOWS THAT IF THE MISTAKES ARE CORRECTED, ECONOMIC PROGRESS CAN RESUME.

EVEN IN COUNTRIES VERGING ON ECONOMIC COLLAPSE, WHERE THE ASSISTANCE PROVIDED UNDER THE BAKER PROPOSALS IS MOST URGENTLY NEEDED, WE ARE SEEING CHANGES THAT OFFER HOPE FOR AFRICA. THINGS ARE DEFINITELY HAPPENING, THINGS THAT CAN LEAD TO SUCCESSFUL REHABILITATION, GIVEN AFRICAN PERSEVERANCE AND SOME OUTSIDE SUPPORT.

THE CHANGES COME FROM AFRICANS THEMSELVES. SIDE BY SIDE WITH DESPERATE NEED THERE IS A NEW PRACTICALITY. WITH THE ASSISTANCE CONTEMPLATED UNDER THE BAKER PROPOSALS, THIS NEW PRACTICALITY CAN BE ENCOURAGED AND NURTURED UNTIL IT TAKES HOLD AND BREATHES NEW ENERGY INTO ECONOMIC LIFE.

INDEED, WE ARE SEEING SOME CORRECTIVE DECISIONS IN AFRICA ALREADY. IN ZAMBIA, FOR EXAMPLE, PRESIDENT KENNETH KAUNDA HAS

PURSUED FOR SOME TWENTY YEARS A HUMANISTIC PHILOSOPHY THAT HE EARLY TRANSLATED INTO ECONOMIC POLICY AS A PROLIFERATION OF STATE INTERVENTIONS INTO PRODUCTION AND DISTRIBUTION. HE NATIONALIZED THE COUNTRY'S COPPER INDUSTRY--ITS ECONOMIC BASE AND VIRTUALLY ITS SOLE EARNER OF FOREIGN EXCHANGE--AND THEN USED THE REVENUES TO SUPPORT A LARGE NUMBER OF UNECONOMICAL STATE ENTERPRISES PROVIDING GOODS AND SERVICES TO THE ZAMBIAN PEOPLE.

SO LONG AS COPPER PRICES REMAINED HIGH, THE SYSTEM FUNCTIONED, BUT WORLD DEMAND FOR COPPER HAS FALLEN, WHILE PRODUCTION HAS INCREASED, AND COPPER PRICES HAVE BEEN AT HISTORICALLY LOW LEVELS ALMOST CONTINUOUSLY SINCE THE MID-1970S. THE OUTFLOW OF CASH TO PROVIDE FOOD, FUEL, AND OTHER BASICS FOR THE ZAMBIAN PEOPLE HAS SO FAR OUTSTRIPPED THE COUNTRY'S EARNINGS THAT BY 1983 ITS DEBT HAD RISEN TO SOME $2.6 BILLION, OR ABOUT $400 PER ZAMBIAN. DESPITE SEVERAL IMF PROGRAMS AND A RESCHEDULING OF THE DEBT REPAYMENTS, ZAMBIA'S FINANCES ARE IN EXTREMIS TODAY.

AND YET, I SEE ENCOURAGING CHANGES IN ZAMBIA. PRESIDENT KAUNDA IS A PRAGMATIST AS WELL AS A PROVEN HUMANITARIAN; HE SEES THE RESULTS OF EARLIER POLICIES, AND HE IS MOVING TO CORRECT THEM. FOR EXAMPLE, INSTEAD OF FUNNELING HARD CURRENCY REVENUES DIRECTLY INTO THE NATIONAL TREASURY, THE GOVERNMENT NOW ALLOWS THE COPPER COMPANY TO RETAIN FUNDS NEEDED TO REEQUIP AND REHABILITATE ITS MINES AND SMELTERS. THE COUNTRY WELCOMES FOREIGN INVESTORS, ESPECIALLY IN AGRICULTURE AND INDUSTRY.

DOMESTIC EXPORTERS ARE NOW ALLOWED TO KEEP HALF OF THEIR FOREIGN CURRENCY EARNINGS FOR THE PURCHASE OF EQUIPMENT AND RAW MATERIALS.

JUST THIS MONTH THE CENTRAL BANK, AIDED BY ADVISERS FROM THE IMF, ANNOUNCED THE CREATION OF A FOREIGN EXCHANGE AUCTION SIMILAR TO THE ONES ALREADY ESTABLISHED IN ZAIRE AND UGANDA, AT WHICH IMPORTERS ARE ABLE TO BID FOR FUNDS TO OPERATE THEIR BUSINESSES. AT EQUATOR, WE SEE THESE CHANGES AS EVIDENCE OF NEW REALISM, AND ALREADY THEY ARE PRODUCING RESULTS. DURING THE PAST YEAR THE FREEING OF PRICES FOR GRAINS, ALLOWING PRODUCERS A REALISTIC RETURN FOR THEIR INVESTMENT AND LABOR, HAS STIMULATED A BUMPER CROP OF MAIZE. THIS IS A WELCOME DEVELOPMENT AFTER YEARS OF DROUGHT AND OPPRESSIVE CONTROLS ON FARMERS. EVEN DURING THE DROUGHT, COTTON PRODUCTION INCREASED BECAUSE FARMERS WERE RECEIVING HIGHER MARKET PRICES FOR THEIR CROPS.

WHEN I WAS IN SEOUL TWO WEEKS AGO FOR THE IMF/WORLD BANK MEETINGS, I NOTED WITH INTEREST TREASURY SECRETARY BAKER'S CALLS FOR SWEEPING MEASURES TO REDUCE THE INTERNATIONAL DEBT CRISIS, INCLUDING HIS RECOMMENDATION OF A SPECIAL FUND TO HELP THE POOREST AFRICAN COUNTRIES IF THEY WILL ADOPT POLICY REFORMS TO SAVE THEIR ECONOMIES. I ALSO HEARD SCEPTICISM FROM THE WORLD'S COMMERCIAL BANKERS, WHO WILL BE RELUCTANT TO PUT ADDITIONAL MONEY INTO NATIONS ON THE VERGE OF DEFAULT. I WOULD ARGUE THAT ZAMBIA IS A COUNTRY ALREADY STRUGGLING TO MEET SECRETARY BAKER'S TESTS FOR POLICY REFORM, AND WILLING TO GO FURTHER. I WILL SAY ALSO

THAT EQUATOR IS A BANK WILLING TO PUT NEW MONEY INTO ZAMBIA IF ITS REFORMS CONTINUE AND IF THE PROPOSED IMF, WORLD BANK, AND AMERICAN PROGRAMS HELP BRING ITS FINANCES BACK FROM THE BRINK.

LET ME CITE ANOTHER COUNTRY AS AN EXAMPLE. THE PEOPLE'S REPUBLIC OF MOZAMBIQUE IS IN TURMOIL TODAY, A TURMOIL ABETTED BY THE GOVERNMENT OF SOUTH AFRICA'S CLANDESTINE SUPPORT TO A REBEL MOVEMENT THAT HAS DISRUPTED THE COUNTRY'S ECONOMY THROUGH GUERRILLA ATTACKS ON PRODUCTION AND TRANSPORT. IN AN EFFORT TO SECURE PEACE, PRESIDENT SAMORA MACHEL SIGNED THE NKOMATI AGREEMENTS WITH SOUTH AFRICA IN MARCH, 1984, AND TO REVIVE THE ECONOMY HE UNDERTOOK A SERIES OF POLICY REFORMS THAT MOVED MOZAMBIQUE FROM CENTRAL PLANNING WITH A COMECON ORIENTATION TOWARDS A PRAGMATIC APPROACH WITH OPENINGS TO THE WEST, NOW INCLUDING MEMBERSHIP IN THE IMF AND THE WORLD BANK.

HAVING DONE SO, PRESIDENT MACHEL MIGHT REASONABLY EXPECT AMERICAN SUPPORT, AND HIS RECENT VISIT TO THE WHITE HOUSE INDICATES THAT THE ADMINISTRATION RECOGNIZES THE IMPORTANCE OF HIS SHIFT IN POLICY. BUT WE ARE TALKING ABOUT AN ECONOMY IN THE LAST STAGES OF COLLAPSE. IF THIS PATIENT WERE HOOKED UP TO A LIFE SUPPORT SYSTEM, ITS ALARMS WOULD BE RINGING WILDLY AND ITS MONITORS WOULD SHOW THE RAPID EXTINCTION OF ANY REMAINING SIGNS OF LIFE. THE SITUATION CALLS FOR IMMEDIATE, INTENSIVE CARE, AN URGENT INFUSION OF AID. THE AMOUNT NEED NOT BE GREAT, IN THE CONTEXT OF AFRICA'S OVERALL DEBT, BUT IT MUST BE ENOUGH, SOON ENOUGH, TO PUT THE COUNTRY'S FINANCES IN ORDER, RESTORE

CONFIDENCE IN THE NATIONAL CURRENCY, AND MAKE ORDINARY CONSUMER GOODS AVAILABLE. CONSUMER GOODS ARE IMPORTANT BECAUSE THE FARMERS WILL NOT GROW MORE, EVEN THOUGH PRODUCER PRICES HAVE RISEN, UNLESS THERE IS SOMETHING IN THE SHOPS ON WHICH TO SPEND THEIR MONEY.

AT EQUATOR WE ARE FAMILIAR WITH A NUMBER OF COUNTRIES, LIKE ZAMBIA AND MOZAMBIQUE, THAT HAVE OPTED FOR THE PRAGMATIC APPROACH THAT REDUCES THAT GOVERNMENT'S ECONOMIC RESPONSIBILITIES AND FREES THE DOMESTIC PRIVATE SECTOR. TODAY THE LIST PROBABLY INCLUDES MORE THAN HALF OF THE COUNTRIES ON THE CONTINENT.

AS I SAID EARLIER, AFRICA'S ECONOMIC PROBLEMS ARE PROFOUND AND LONG TERM, AND THEIR SOLUTION WILL BE THE WORK OF GENERATIONS. BUT THIS SHIFT IN BASIC POLICY, WHICH GOES WELL BEYOND THE AUSTERITY MEASURES NORMALLY EXTRACTED UNDER IMF CONDITIONALITY, GIVES US MORE HOPE TODAY THAN WE HAVE FELT IN THE TEN YEARS THAT EQUATOR HAS BEEN IN EXISTENCE. I WOULD EMPHASIZE THAT AFRICAN GOVERNMENTS HAVE RUN OUT OF ALTERNATIVES: THERE ARE NO RADICAL MODELS LEFT UNTRIED, NO SUPERPOWERS BIDDING FOR THEIR LOYALTIES, NO PETRODOLLARS WAITING TO BE RECYCLED.

WE BELIEVE THE UNITED STATES SHOULD ENCOURAGE THESE REFORMS AND HELP THEM TO TAKE HOLD. I WILL MENTION BRIEFLY SOME OF THE OTHER STEPS WE THINK THE ADMINISTRATION CAN BEGIN TO TAKE QUICKLY. WE HAVE DIVIDED THESE MEASURES ACCORDING TO WHETHER

THEIR EFFECTS ARE SHORT TERM OR LONG TERM; BOTH KINDS ARE NECESSARY.

SHORT TERM

1. PROVIDE GRANT ASSISTANCE IN THE FORM OF FOREIGN EXCHANGE TO REHABILITATE EXISTING PRODUCTION FACILITIES, ESPECIALLY THOSE WITH EXPORT MARKETS.

2. CONTINUE TO SUPPORT EXISTING U.S. INSTITUTIONS, SUCH AS EXIMBANK, OPIC, AND AID'S BUREAU FOR PRIVATE ENTERPRISE, THAT FOSTER AMERICAN LENDING, INVESTMENT, AND TRADE IN AFRICA.

3. VOICE OUR SUPPORT OF THE AFRICAN ENTREPRENEUR THROUGH APPOINTMENT OF A TEMPORARY SPECIAL AMBASSADOR WHO WILL CONCENTRATE ON DEVISING PROGRAMS TO REINFORCE POLICY CHANGES THAT BUILD THE PRIVATE SECTOR.

LONG TERM

1. USE AMERICAN FINANCIAL AID TO HELP PRIVATIZE PARASTATAL FIRMS BY HELPING AFRICAN GOVERNMENTS RECOUP THEIR CAPITAL COSTS.

2. INSURE AGAINST EXCHANGE RATE FLUCTUATIONS TO FREE AID PROJECT LOAN FUNDS CURRENTLY LANGUISHING BECAUSE RECIPIENTS REFUSE TO TAKE THE RISK.

3. PROMOTE THE DEVELOPMENT OF AFRICAN CAPITAL MARKETS TO SMOOTH THE WAY FOR CREATING AND BUILDING COMPANIES.

3. INCREASE BUSINESS EDUCATION AND TRAINING--CREATE A FULBRIGHT PROGRAM FOR BUSINESS MANAGERS.

4. IMPROVE OR REHABILITATE INFRASTRUCTURE NEEDED BY BUSINESS, ESPECIALLY TRANSPORT AND COMMUNICATIONS.

5. INCREASE AFRICA'S EXPORTS TO THE INDUSTRIAL WORLD, INCLUDING THE UNITED STATES.

MADAM CHAIRWOMAN, AS YOU CAN SEE, AT EQUATOR WE ARE CONVINCED THAT POLICY-BASED ASSISTANCE FROM THE UNITED STATES GOVERNMENT IS BOTH URGENTLY NECESSARY AND DIRECTLY BENEFICIAL FOR THE REVITALIZING OF AFRICA'S ECONOMIES. THE SITUATION IS GRIM AND STILL DETERIORATING RAPIDLY. YET THE STAGE IS BEING SET FOR RECOVERY AND THE UNLEASHING OF PRIVATE ENERGIES. AS THE WORLD'S LARGEST FREE MARKET ECONOMY, AMERICA SHOULD TAKE THE LEAD IN HELPING AFRICANS TO COMPLETE THIS ECONOMIC REVOLUTION SUCCESSFULLY.

HOPE FOR AFRICA

By Niles E. Helmboldt, President
and Benjamin H. Hardy, Vice President
Equator Holdings Limited
Hartford, Connecticut
October 24, 1985

Africa's economies have come to a dead end. This is scarcely a shocking statement; not a week goes by without the news media pointing with alarm and perhaps a trace of smugness to Africa's abysmal economic performance. The implication is that, despite large amounts of outside assistance in the form of grants, loans, and technical assistance during the generation since independence, Africa has backslid into futility, its path greased by political instability, corruption, waste, ignorance, and mismanagement.

While this picture may be accurate in many of its facts, it obscures the truth of Africa's achievements and potential. By potential we mean its immediate, available resources as well as its productivity in the future. In the generation since independence a number of African governments have sought to improve social services, especially education, with the result that today there are, widespread illiteracy notwithstanding, a substantial number of trained minds available. Africa now has intellectual resources that did not exist at independence.

In addition, there has been substantial capital investment in Africa by governments, multilateral agencies, and private firms to create new productive capacity in agriculture and industry. Some of that capacity stands waiting now, idle or underused. Africa's capital needs today are not so much for investment in new projects, but additional foreign exchange to buy spare parts and raw materials to call that capacity back into production. These circumstances, coupled with the patience and endurance of the African people, lead us to believe that even now there is hope for Africa.

The very depth of the current economic crisis makes today a starting point for a better Africa. Things have gotten so bad that the policies of a quarter-century, the era of post-colonial and post-independence political leadership, are clearly seen by everyone to be intellectually, morally, and economically bankrupt. Whatever the good will with which they were adopted, these policies have failed to create the social justice, economic growth, and political responsibility they were intended to produce.

Of course, there are those who still look outside of Africa for the source of its troubles. They certainly have some evidence to back their arguments. The deterioration in Africa's terms of trade, particularly through weak commodity prices during

the recent worldwide recession, has created a latter-day Great Depression that is still widespread even though several countries have begun to recover from it. Likewise, several years of drought have devastated food production over wide areas of the continent, and the ensuing destruction of farmlands and grazing ranges, with accompanying loss of seedstocks and breeding herds, will take years to rebuild. The combination of drought and hard times has recreated scenes from our own dustbowl of the nineteen thirties, but on a scale of misery that taxes the imagination. The heavy burden of foreign debt, while not as great as that of Latin America, is absorbing upwards of fifty percent of foreign exchange earnings in some African nations, money that could otherwise be used to provide imports essential to economic rehabilitation and production.

Regardless of these outside forces, the fact remains that a large part of the blame for Africa's present crisis lies in the policies its leaders have pursued during the past twenty-five years. Most African political leaders have behaved responsibly, but mistakenly, in making economic decisions for their countries. It follows that by changing their policies they can create conditions that will lead to improvement. We would add that they have run out of alternatives: there are no radical models left untried, no superpowers bidding for their loyalties, no petrodollars waiting to be recycled.

Given the great variety in political, economic, and social conditions across Africa's fifty-odd countries, it is not surprising that the economic policies of the past quarter-century differed in detail from country to country; the ideology and rhetoric varied as well. But there was unity in the underlying article of faith that in order for Africans to recover from colonialism and create a modern society, they would have to give the state the central role in the economy.

The inflated, weak state

The first post-independence generation reserved to the state the economic functions that should have been left to the people. Everywhere in independent Africa, governments took on excessive economic responsibilities. Not only did they have to serve as final arbiters of economic justice, a role governments take on almost universally around the world today, but they also tried to be the main engine of economic progress.

State-owned corporations entered every sector of the economy; Tanzania, for example, now has several hundred of them. State marketing boards and regulatory agencies intervened at all levels of activity, even in nominally free and open economies such as Nigeria, Kenya, and the Ivory Coast. In some countries, such as the Congo, the government became the employer of last resort, undertaking to hire most of the school leavers entering the job market each year.

Ideology actually had very little to do with this; it happened whether the leaders were from the left or the right. Perhaps the Marxists were more strongly motivated, but the conservatives simply followed the examples of the capitalist economies of the colonial metropole, with about the same result.

What caused African leaders to turn the economy over to the state? In large measure it was their lack of political experience. First, for many their only firsthand experience with government was that with the colonial regimes in their own countries, regimes that dominated the economic lives of the population. Second, they saw the new state apparatus as a means to consolidate personal political power, so they tried to make it as big and pervasive as possible. Third, and perhaps most important, they vastly overestimated the capacity and effectiveness of their governmental institutions. They simply took on far more than the fragile political system and administrative apparatus was capable of doing. Probably all of these errors arose out of the colonial experience.

This is not to put the blame for the current crisis on the colonial powers. These were decisions taken by Africans; they can be undone by the same Africans, or by the younger generation now coming into leadership positions. Today there is a generation with the requisite political experience.

Now, what policy reforms are going to revitalize Africa's economies? It will come as no surprise that, as a private firm deeply involved in African economic activity, Equator strongly advocates a larger role for the private sector in all of these countries.

Benefits of freeing the private sector

Loosening the reins on private business activity is an attractive alternative in numerous ways; we can cite three by way of example. To begin with, a free economy, like a free political system, releases people's creative and productive energies. During the past generation in Africa, opportunities for vigorous and imaginative work have been systematically choked off.

In some countries government expanded so far that virtually the only two categories of activity were government service and peasant agriculture, with the former exploiting the latter. Smallholder farmers were so severely discriminated against, through price controls and administrative regulations, that millions abandoned their farms and migrated to the towns in the hope of participating in the modern economy bankrolled by the government. The bureaucracy proved to be so ineffective, stultifying, and politicized that the ambitious gave up hope and the dedicated abandoned their ideals in favor of corruption. Many of the most talented and best educated quit their home countries for opportunities abroad.

Fortunately, a few highly original thinkers managed to create productive enterprises and to thrive even in this hostile environment; at Equator we consider ourselves privileged to have some of them as our clients. We believe Africa needs many more of them.

Another attractive aspect of freedom for the private sector is that it is compatible with African cultures. There may be exceptions to this broad generalization, but traditional society in Africa included a substantial merchant class. Everywhere in Africa there were (and still are) strong traditions of community responsibility, especially to the immediate and extended family, the village, and the tribe. These traditions formed a network of mutual obligations that assured care for the least fortunate. Within this system there was generally considerable room for the pursuit of individual achievements. While it is true that Africa's most successful entrepreneurs engaged in trade rather than production, it remains that there was considerable scope for private initiative. Here and there today we are seeing that individualism expressed in production, especially in the informal, family-based enterprise and in the modern manufacturing sector.

Finally, the most attractive aspect of the expanded role for the private sector is that it doesn't cost the government anything: it suffices for the government to stop what it is doing, step to one side, and allow its citizens to pursue their own productive interests. Government can cut its budget deficits by eliminating activities that operate at a loss. It can even increase its revenues by taxing internal production and commerce, rather than manipulating producer prices and taxing or expropriating commodity exports.

Difficulties in making the change

Opening up the private sector will not be a simple matter of announcing policy changes by fiat. As dismal as the record of economic growth in Africa has been, there are still many advocates for state intervention in the economy, both within Africa and among the outside observers and advisers whose counsels have contributed to the current situation.

An immediate and widespread issue is that private enterprise, free enterprise, free markets, and capitalism are terms with a bad reputation in many parts of Africa. Economic activity for private gain is widely synonymous with greed and corruption. This identification arises in part out of the colonial experience, when Africa's labor and resources were expropriated, sometimes forcibly, in the name of profit. It may also have had something to do with the adoption of Marxist models of government and economic organization, although anticapitalist regimes certainly have not been immune to the virus of corruption. It is worth noting also that the worst object

lessons in corruption have occurred in countries where government allowed private activity but interfered with and tried to take advantage of it. The worst excesses, in fact, involve government officials responsible for economic policies and controls, who have lined their pockets through theft, bribery, and extortion in the conduct of their official duties. They have taken money from businessmen in exchange for allowing them to do what would be freely allowed in a market economy.

Another concern is that a free market economy is one open and vulnerable to manipulation by powerful outsiders such as multinational corporations. Given the weakness of governmental institutions in Africa, such concern is more readily justified there than in nations already well-advanced towards development and industrialization. Sovereign African nations have every right to protect themselves against foreign exploitation, and developing nations are justified in creating barriers that promote their domestic industries, especially export industries.

Indeed, the future thrust of policy reform in Africa must be to make investment attractive to Africans, never mind foreigners. Over the past quarter-century, Africans who have succeeded in amassing any capital have tended to invest it in local real estate or they have smuggled it abroad. The incentives to invest in productive enterprise at home have been so poor that capital has naturally migrated towards more attractive outlets, most of them far away. Not until investment opportunities are attractive to Africans will they be really attractive to foreigners. African governments that seek foreign investment should bear this in mind.

Reforms designed to permit free access to economic opportunity face another difficult social problem, that involving ethnic communities not native to Africa, communities such as the Indians, Lebanese, and others who have made their homes in African countries, some of them for several generations now. In addition, there are thousands of Africans who have migrated to neighboring countries in search of opportunity.

It goes without saying that no nation can allow its citizens to be victimized by the machinations of the unscrupulous. On the other hand, there are people of immigrant stock whose roots are firmly anchored in African soil, and whose skills and loyalties are not lightly to be dismissed, regardless of the momentary political advantage. The example of Uganda under Idi Amin confirms this. Yet how are African leaders to protect their people from exploitation? This is a complex problem, charged with emotions, yet the best solution in the long run is a system of business ethics, backed by a legal code and administration, that is unbiased and evenhanded with regard to ethnic and national origins.

Necessary steps towards reform

Most governments in sub-Saharan Africa urgently need to make changes in their existing economic policies; fortunately, many are already doing so, although it is sad that the impetus in most cases has been the extreme depression of the past several years. The decision in favor of policy reform is political in its essence, one that Africans must make for themselves. Having reached such a decision, however, governments have at their disposal a number of concrete steps that will help to reinvigorate their economies. Some of these steps are short term and likely to bear fruit almost immediately, while others take longer to implement and will require a number of years to produce results.

Short term reforms. Some of the short term changes are already being adopted in Africa. Equator has examined short term policy reforms in a paper, "African Economic Policies and Foreign Investment," soon to be published by the Committee on African Development Strategies, cosponsored by the New York Council on Foreign Relations and the Overseas Development Council.

Chief among these are efforts to promote smallholder farm production, to alleviate the famine problem and conserve foreign exchange now spent to import food; encourage the small, often family-based, producers of goods and services for local consumption in the villages and towns; and rehabilitate medium to large scale manufacturing in the cities, factories that now operate at a fraction of capacity because there is no foreign exchange for replacement machinery, spare parts, supplies, and essential imported raw materials. While there has been an immediate increase in production from farmers wherever they now get realistic prices for their food, their new purchasing power needs to find outlets in the other two sectors. Governments that have now begun to allow exporting manufacturers to keep a portion of their foreign exchange earnings are thereby setting the stage for an increase in locally available consumer goods.

These are measures chiefly for African governments; we have assumed throughout that Africa will have to do most of its own recovery. However, in our paper we identified several steps that the United States can take to encourage Africans and promote their efforts' success. Rehabilitation is going to require foreign exchange, so capital flows must continue unabated and, if possible, be augmented to reflect the severity of the current crisis. Congress and the Administration should also continue to support existing institutions that foster American lending, investment, and trade in Africa, including Eximbank, OPIC, and AID's Bureau for Private Enterprise. We also advocate more vocal American support of the African entrepreneur in those countries receptive to reform; hence, we recommended appointment of a temporary special ambassador who will concentrate on devising programs to reinforce policy changes that build the private sector.

Long term reforms. For the longer term, the steps are harder to define in concrete terms. Recently the Aga Khan, who maintains a home in Nairobi, Kenya, has spoken of the need to create an "enabling environment" in Africa hospitable to economic development. This refers to a set of moral and ethical values, constitutional principles, laws, regulations, and shared practices that are understood and agreed to by those participating in the economy. It also encompasses the economic institutions of government, banking and finance, manufacturing, services, and trade.

This is an environment that Africans must create for themselves. The values and institutions that were imposed upon Africa or that Africa has borrowed from the rest of the world have not fared well during the past generation; they come up hard against cultural resistance that disarms and dissipates them. Yet policy-based assistance, whether from the United States, other Western nations, or multilateral agencies such as the World Bank can help to promote the enabling environment if the donors are firm in their demands for reform and flexible in their acceptance of adjustments to local conditions.

Second, it will be necessary to identify and foster the geographic relationships that can undergird and sustain economic development. Trade between the African city and its neighboring towns, among growing cities within Africa, and between African economies and the rest of the world will have to be nurtured. Few population centers in Africa today are also major producers of goods and services; rather they are administrative centers, the product of inflated government. All too often, the hinterland of this administrative nexus is inadequate both as resource base and as market: in some cases, the African nation-state is an economic mistake, another sad artifact of the colonial era, either too large or too small, and too irrational economically to stand the test of history. This is as much a political as an economic problem, complicated by a generation's firm adherence to the principle of the inviolability of national boundaries as they existed at independence.

However, Africa can reduce the economic inconvenience of these artificial barriers by creating effective regional and continental market mechanisms. Some of these, such as the Economic Community of West African States (ECOWAS) and the Southern Africa Development Coordination Conference (SADCC), already exist, but the crisis conditions make progress very slow. The United States and other OECD nations can help make these arrangements more effective by planning project assistance on a regional, rather than solely national, basis.

Third, Africa must face and overcome its population predicament. The inexorable birthrate is a social problem that arises out of the people's most closely held cultural values. It operates with the force of nature. Not only does it outrun Africans' attempts to increase per capita food production, it

also throws up economic, social, and political problems that are already large today but will reach staggering proportions in ten or twenty years even if the birthrate starts falling today, which almost certainly it will not do. Demographic statistics for Africa are unreliable, but the trends are clear. In some countries close to half of the population is under fifteen years of age, dependent for education, health, and future employment on the older half that is not much older and is just as ill prepared. Africa is a continent of children, many of them without much future unless things change. The United States should encourage the efforts of African public and private health organizations to promote family planning and educate the people at the grass roots, using Planned Parenthood and other competent international organizations.

New initiatives for the United States

During recent weeks the Reagan Administration has itself injected new hope into efforts to help Africa. By presenting the world with a series of proposals to deal with the international debt crisis and the plight of the poorest developing nations, the United States is taking the lead. The debate, now strongly invigorated, will probably last for months, yet the door has been opened for fresh ideas.

If the United States, other Western industrial nations, and multilateral institutions such as the IMF and the World Bank are going to make substantial resources available to African nations to spur their economic policy reforms, make their debt burdens more bearable, and rehabilitate their productive sectors, then they must be open to recommendations that use the money to strengthen the private sectors of African economies.

In order to establish American leadership in this effort, the Administration should adopt imaginative methods for making its financial assistance effective immediately and with maximum benefits. New methods are called for, inasmuch as the Agency for International Development and other executive agencies for implementing U.S. policy abroad have traditionally worked almost exclusively with host governments, rarely with private institutions, and almost never for the benefit of private, profit-oriented firms. Existing methods have evolved within the constraints of diplomatic practice, which in its essence deals with relations between states, and yet this has not prevented a host of private relationships from developing under governmental auspices--for example, in the areas of scientific, technical, and cultural exchange. America will need new programs within existing institutions, such as the Departments of State and Commerce, AID, USIA, Eximbank, and others. We outline some suggestions for such programs below.

1. **Use American financial aid to help privatize parastatal firms.** In African countries there exist a wide variety of state-owned and state-operated corporations created to provide goods and services to the national populace. The first step in dismantling this apparatus is to perform a kind of triage, identifying those firms that should remain under government ownership (those essential to national defense or social welfare, for example small-arms manufacturers or postal services), those that should be closed down and abandoned, and those with viable products or markets and saleable capital assets.

The third category, of course, contains the candidates for privatization, but it is precisely here that governments find it most difficult to make decisions. It is hard to persuade political leaders that they should give up a going concern, especially one providing a needed service that yields a real or potential profit. Nevertheless, it is only these firms that are attractive to businessmen as acquisitions. It may not be easy to find a buyer able to make the substantial capital investment needed to acquire the firm's assets, particularly if a large amount of imported machinery, equipment, or raw material is involved.

It is in cases like this that American financial assistance can make an important difference. To cite a hypothetical example, if the government of Guinea wants to sell off the domestic airline linking Conakry with the interior, it must find qualified buyers possessing the necessary management skills and able to pay for the aircraft, spare parts, hangars, telecommunications equipment, etc., most of which were imported and for which the government may still be paying under long term loans. Unless someone helps the government to pay off those loans, in effect recouping its equity in the airline, the government will be reluctant to divest itself of the firm despite its drain on the national budget and its inefficiencies in serving the general public. The local buyer cannot pay in foreign exchange, the government's longstanding policies having made it difficult or impossible for private citizens to hold foreign currencies or maintain accounts abroad.

We believe that the United States government can be the critical catalyst making privatization possible in such a case, by providing the dollars necessary to pay for the buses aircraft either directly to the government or to the local purchaser. In the former case, the money could be a grant, or a long-term loan to be repaid dollars or in local currency. In the latter case, the new owner acquires an obligation to an agency of the U.S. government, to be paid off either in local currency (which then are added to counterpart funds available for other aid projects) or, in the case of a firm with export potential, in retained foreign exchange earnings. Better, an agency of the U.S. government (OPIC, for example) might guarantee or insure such an obligation funded by a private bank.

2. **Insure against exchange rate fluctuations.** In many African countries USAID loan funds are underutilized because, while the need is urgent and the commitment to repay is firm, the government is unwilling to assume the foreign exchange risk inherent in future dollar obligations. The strength of the dollar during the past several years, with its concomitant burden of sharply increased debt service, makes these countries leery of accepting money on terms that may escalate in response to foreign exchange market forces. It would be a relatively simple matter to pass legislation enabling OPIC or a similar institution to provide insurance to African governments receiving U.S. government loans against fluctuations in the value of the dollar.

3. **Promote the development of African capital markets.** As an African Marxist economist remarked more than twenty years ago, "You can't be a capitalist if you haven't any capital." He referred, of course, to the poverty of his compatriots after a century of colonialism; yet the point has acquired additional irony in the ensuing years, as state interventions in economies effectively blocked the accumulation of funds for investment in production. As a result, the natural evolution of small and medium-sized financial institutions never occurred, and the withdrawal of government from the economic arena will leave a void that may take many years to fill if left to local skills and resources.

Three conditions essential to the nurturing of capital markets include (a) stability in the business environment such that businessmen believe their investments to be secure from government interference not only today, but for the future, (b) relinquishment of government control over a share of the nation's total capital large enough to enable individuals to accumulate it in quantities suitable for investment, and (c) either a lengthy period of slow institutional evolution or an injection of capital to speed the process.

A number of the successful entrepreneurs whom we know got started with small "equity" loans from commercial banks; there were and are no venture capital firms in Africa. There are a few intermediate-sized financial institutions (IFIs), but the funds and the means to deliver them to would-be entrepreneurs are missing. The Bureau for Private Enterprise (PRE) at AID worked successfully for a time to strengthen these IFIs by providing them guarantees covering a majority of portfolio in order to encourage their investments. At the time PRE's authority for this program expired in 1984, it was developing an extension of the idea to include guarantees to foreign lenders putting funds into these IFIs. AID's authority to provide such guarantees should be revived and strengthened. Considering that the Administration's proposals to manage the debt of developing countries include plans to have private banks restore and increase their lending, there exists an opportunity to channel a portion of that money into the creation of capital markets through this program.

4. **Increase business education and training.** Africa's three most pressing economic needs are capital, modern technology, and management skills. Although the number of Africans with advanced education has increased manifold during the past twenty-five years, in percentage terms it is only a bare beginning. For a generation, university-trained Africans have tended to prepare themselves for government service and to enter the bureaucracy upon completion of their education. Because the private sector was neglected, in many cases disparaged, relatively few Africans sought training in business skills such as general management, production, marketing, finance, labor relations, and the like. The result has been the creation of myriad small companies whose founders are self-taught and who tend to oversee the entire spectrum of business activities because they have no reliable middle managers. This limits corporate growth and reduces the likelihood that the business can be passed along intact when the founder retires.

We believe that the United States, because it has the most extensive and advanced business education system in the world, is the natural partner to help Africa build its pool of management skills. Africa needs the equivalent of a Fulbright program for business managers. In addition to opening up the American university system to African business students, there is much to be done in Africa itself to prepare future applicants to this program, and to train managers on the scene, managers who cannot be spared for schooling abroad. Now that the Department of Commerce has its own career foreign service, it can expand its role in developing countries by teaching a full range of business skills. Perhaps the embassy's commercial section can join forces with the AID mission and the U.S. Information Service library to create a training center for local businessmen, a center equipped with books, computers, instructors, and advisers. If America is going to be the advocate of African private enterprise, it should put its money and its knowledge behind that advocacy.

5. **Improve or rehabilitate infrastructure needed by business.** Part of Africa's crisis arises from the deterioration of infrastructure which is, on the one hand, incompletely or improperly maintained (again a problem of management and technical skills) and, on the other hand, subject to harsh conditions of nature and heavy use. In Zambia, for example, the return of ample rainfall after several years of drought produced a bumper grain crop this year, but poor road maintenance, shortages of tires and truck parts, and an inadequate supply of storage bags threatened the crop; in the best years, Zambia loses perhaps forty percent of its grain harvest to vermin and water damage due to poor storage.

Another serious handicap for business is limited transport and communications. Africa is a vast land mass, more than three times the size of the United States. Both its road and rail networks are inadequate to meet the economic needs of a population exceeding 400 million. However, air transport was

made for this continent: the growing system of national and international airlines, general aviation, and aviation services, including airports, is helping African nations leapfrog several stages of transport development and enter the twentieth century at jet aircraft speed. Much of the equipment used in this system is produced in the United States; U.S. government export promotion programs, especially Eximbank finance, remain essential to maintaining this advantage.

The solution to Africa's communications problem lies in large-scale telecommunications systems, key elements of which would be geosynchronous satellites, a network of ground transmitters, a far larger network of dish receiver antennas, and cheap but sturdy radio and television sets operating on a variety of power sources--local alternating or direct current, motor vehicle batteries and generators, and dry cells. With high quality educational programming, and news services providing rainfall and crop reports, prices on farm markets, and the like, such a system would perhaps do more to spread knowledge and improve productivity in Africa than any other single agent of change. Again, this is an area where private enterprise, African as well as foreign, could take responsibility, with governments, including that of the United States, providing export support and limited foreign exchange assistance in the form of long term loans.

6. **Increase Africa's exports to the industrial world, including the United States.** Africa can only grow if it can sell its products. Ultimately, Africa's best markets will be within the continent itself. Africans selling to Africans will be the continent's salvation. For the present, however, Africa needs overseas markets to earn the foreign exchange it needs to build its productive capabilities. Just as America sold raw materials to the world until its industrial base became strong enough to compete internationally, Africa can draw upon its vast natural resources. It can grow and change, however, only if America and the other free market industrial economies buy its exports, including not only commodities such as coffee, tea, cocoa, palm oil, timber, cotton, iron ore, phosphates, and petroleum, but also processed and manufactured goods: instant coffee, fresh and canned fruits and vegetables, cut flowers, plywood and veneers, furniture, textiles, twine and rope, glass, plastic pipe, copper wirebars, and steel billets.

At a time when demands for protectionism have become a political issue in the United States it may be difficult to take a stand in favor of helping these developing nations earn their way out of their Depression, but in the long run it is the best way to resolve many of their economic, social, and political problems. One way to facilitate American imports of African products would be to assert Eximbank's long neglected responsibility for promoting imports. Title 12, Part 402.1 of the U.S. Code (1984) states that "the basic purpose of the Bank is to aid in financing and to facilitate exports and imports and the exchange of commodities between the United States or any of its Territories or insular possessions and any foreign country or the agencies or national thereof." Whether through this means or some other, steps to increase the flow of goods from Africa to the rest of the world will pay important dividends in economic development.

Conclusion. At Equator we are convinced that policy-based assistance from the United States Government is both urgently necessary and directly beneficial to the revitalizing of Africa's economies. The situation is grim and still deteriorating rapidly. Yet the stage is being set for recovery and the unleashing of private energies. As the world's largest free market economy, America should take the lead in helping Africans to complete this economic revolution successfully.

Senator KASSEBAUM. Thank you very much, Mr. Helmboldt.

We are happy to have with us now Mr. Moose. We are waiting to hear from you about your experiences.

STATEMENT OF RICHARD M. MOOSE, SHEARSON LEHMAN BROS., INC., AND FORMER ASSISTANT SECRETARY OF STATE FOR AFRICAN AFFAIRS

Mr. MOOSE. I am very happy to be here, Madam Chairman. I appreciate the invitation. I am very pleased to follow Bill Dale and Niles Helmboldt, each of whom, in his own way, has played a very active and constructive role in Africa and continue today to do so. They have a lot of direct, first-hand experience in the problems that the committee is examining.

I am pleased that the committee is devoting this much time to this subject.

I had a number of things prepared that I might have said, and I thought I would wait and see what the administration witnesses say. I guess it will be a long time before I grow out of the habit of mind of sitting behind the committee members and thinking up questions which should be asked. I still find myself doing that.

The program that was described by the two administration witnesses this morning, Deputy Secretary Whitehead and Assistant Secretary Mulford, is a good start. Although I think it is limited, I would not want to condemn it because it is limited. Secretary Whitehead himself did not make excessive claims for it. He said he did not think it would be sufficient in itself.

I thought there was perhaps one excessive aspect to it, but I will come back to that.

One has to wonder—this is just a passing comment—since the point was reiterated a number of times that the administration is not asking for new money: one must wonder how one is going to get a great deal more money applied to a situation if there is no new money going in. One seldom gets something for nothing.

But I understand that they do hope to redistribute, to reallocate, and to redirect resources that already exist.

Regarding the new trust fund, the money that would be involved I am bound to observe is only, if you divide $2.7 billion by 6 years, only about $450 million a year. Given the size of these debts, that is not a huge amount of money worldwide, although it may sound like quite a lot.

The area in which I felt there was perhaps an over emphasis or an undue stress in the administration's testimony, and which I think the committee might want to examine a little more closely, is their belief in the ability of Africa to grow out of the debt crisis. It is sort of like if you get the macro-economic recipe right and you apply a little more fertilizer—I guess I mean that both literally and figuratively—then Africa will be able to grow out of the problem that currently afflicts it.

Secretary Whitehead said that the measures proposed today can provide the engine of growth that will allow Africa to go forward. I hope he is right. I do not think it is quite a large enough engine and perhaps does not have enough gasoline in it.

Similarly, I think there is excessive expectation on what can come from reform. I don't think there is anything wrong with either reform or growth, as far as they go and as far as they can possibly affect the situations that obtain in Africa today.

Yesterday afternoon, I had the opportunity to be in a conversation that involved the President of Guinea-Bissau and the governor of the central bank of Guinea-Bissau which, as the committee knows, is one of the poorest countries in the world, poor even among the African countries, with a per capita income that is well under $400 a year.

It made me think. I just do not believe that growth in the magnitudes that are being suggested in the testimony that you are hearing is possible on the part of many African economies, no matter how much austerity, reform, liberalization, or privatization they may engage in.

Let me give you the example of Guinea-Bissau yesterday.

The governor of the central bank said that in the past 2 years, they have done—and I made a quick effort to verify this, but the President was sitting there so I think it must be true—that they have devalued, they have taken all sorts of austerity measures and they have liberalized the economy: in short, they have taken every medicine in the cabinet.

As a result, Guinea-Bissau has the expectation this year of making some substantial progress in its foreign exchange earnings. Indeed they hope to earn $17 million this year in foreign exchange. It is a modest amount, but represents a tremendous accomplishment, considering where they were a few years ago.

On the other hand this year their petroleum bill will be between $10 to $12 million and debt service will be $7 million or $8 million. So, with the most optimistic assessment, they would have $3 million left over to buy food, spare parts, raw materials, all of the rest of the necessities. That is about as far as they are going to go.

I do not think the administration's proposal is going to help Guinea-Bissau. I don't think any bank, even Equator Bank—which has to be the bravest bank operating in Africa—is going to loan or invest awfully much in that kind of situation.

I think one of the areas that the committee should examine is one that you, Madam Chairman, raised yourself, I think it is right that you go back and look at it more closely. I refer to the absence of any direct addressing to the question of the debt itself, debt service and the debt stock.

You got close to this in the very interesting exchange between the chairman and the Deputy Secretary about forgiveness. Being a very honest man he said that, as a former banker, he did not really like the sound of that very much. He said maybe some reducing is in order. You asked if he could consider converting debts to grants, and he said that historic debt should remain on the books.

I would have liked for him to have been asked on whose books the debt is going to remain? Even if banks have written down or written off that debt, should governments continue to service it as though it were still fully outstanding?

On the whole question of reflows, the Deputy Secretary was more positive. Again, the Hoover Institution proposal is well worth more examination.

I would like to submit for the record, if I might do so, Madam Chairman, an article written by one of my colleagues who has done a great deal of writing on the African debt situation and on the world debt situation. She is Mrs. Christine Bindert, a senior vice president of Shearson Lehman Bros. She had an article published recently in the magazine, African Event, having to do with the African debt crisis. It contains what I believe are provocative suggestions.

The article appears about the time of the OAU summit, which concentrated on the debt question.

[The article referred to follows:]

SUBMITTED FOR THE RECORD BY RICHARD M. MOOSE

COVER STORY

While Sub-Saharan Africa's debt situation is acute, it could be managed, but only with the extraordinary cooperation by the creditors. Obviously, every effort must be made by the Africans themselves to stabilize their economies, but the burden of the adjustment process should be shared. *Christine Bogdanowicz-Bindert* **suggests how this can be done**

The Smouldering Crisis

Debt has figured prominently on the agenda of several important meetings in recent weeks, including the Interim Committee of the World Bank and the IMF, and the economic summit of industrial country leaders in Bonn. But no attention was paid to the specific problems of Sub-Saharan African debtors.

Sub-Saharan Africa's current financial crisis comes on top of deep-seated economic problems and a decade of decline. Whereas the international community responded generously to the area's plights after the first oil shock, by 1985 Sub-Saharan Africa's sources of financing have declined dramatically. Credits from commercial banks have slowed to a trickle and official assistance has declined in real terms. Multilateral agencies such as the World Bank and the IMF cannot be expected to fill the gap. At the same time, Sub-Saharan Africa's foreign exchange resources have been depleted to less than the equivalent of one month of imports, external arrears have accumulated at a rapid pace as debt service obligations amounting to some 50% of export receipts could not be paid on time.

With export prices relative to the costs of imports 30% lower than 10 years ago, severe drought problems in a number of countries and Sub-Saharan Africa's high dependency on imports of raw material and equipment goods, prospects for a more sustainable foreign exchange situation in the immediate future are bleak.

On the debt front, because of most Sub-Saharan African countries' limited economic leverage vis-a-vis the banks, rescheduling packages have typically been more stringent than those accorded to Latin American debtors and hence have been inadequate in terms of the region's minimum requirements; grace and repayment periods have typically been too short, fees and spreads too high, and banks have usually resisted rescheduling anything but debt payments due in one or two years, whereas the debt problem is clearly one of a long-term nature. Moreover – contrary to the practice in Latin America – bankers have not extended any new credits as part of rescheduling packages to Sub-Saharan African debtors, with the notable exception of Ivory Coast, even though the amounts needed are rather small.

More onerous debt rescheduling packages are only one of the set of special problems facing the debtors. For many Sub-Saharan African countries, slow growth and heavy debt have been a way of life for over a decade. Most suffer from the limited size of their domestic markets and the dependence on exports of a few typically depressed commodities for foreign exchange income necessary to meet their debt service obligations.

In many cases, those countries which tried to make the prescribed adjustments paid a high price domestically: already meager standards of living have further been eroded, underemployment has increased sharply, education services have declined dramatically and health and nutrition have deteriorated dangerously. The intractable characteristics of the Sub-Saharan African situation make it increasingly unlikely that these debt-ridden countries will be able to "grow out" of their current debt service difficulties or reverse the decline in critical standards of living.

Christine A. Bogdanowicz-Bindert

While Sub-Saharan Africa's financial position is acute, it could be managed, but only with extraordinary cooperation by the creditors. Obviously, every effort must be made by the Sub-Saharan Africans themselves to stabilize their economies, but the burden of the adjustment process should be shared. Nothing is to be gained by pushing these debtors into declared bankruptcy.

Beyond industrial countries' fiscal and trade policies, increased resources and more creative roles for the international financial institutions, debt rescheduling packages with commercial banks and creditor countries (Paris Club) will have to be more realistic. As a minimum, banks and other creditors should extend the same terms and conditions to Sub-Saharan African countries as those extended to Latin American debtors such as Mexico and Eduador: multiyear rescheduling, lower spreads, no rescheduling fees and longer grace and repayment periods.

In addition, for major economic changes to be possible and for investments in quick-yielding projects to be stepped up, new financing will be required. Banks and other creditors have to provide the money needed to get Sub-Saharan African economies going again.

All creditors, but most particularly banks, are reluctant to lend to the region. Banks, in addition, have yet to reschedule interest obligations in contrast to official creditors (Paris Club).

Mobutu: his personal fortune is rumoured to equal Zaire's entire debt of $5 billion

Thus, the banks have neither added foreign exchange by way of new credits nor have they sufficiently lessened the overall debt burden of countries in Sub-Saharan Africa. As the region's foreign exchange situation remains critical, banks may have to consider accepting partial payment of interest while deferring the remainder until economic improvements permit full payment. This could be effected for example, by formula linking a country's debt service payments to certain percentage of its export receipts and non-tied capital inflows.

In the 1970s, a 20-25% debt service ratio was considered very high. Today, debt service payments of Sub-Saharan African nations have climbed on average to the 50% range. A flexible debt service payment formula could be introduced to reduce their debt service burden. Under such a formula, a country would allocate, say 25% of its receipts to debt service payments. (Obviously, the exact formula and the percentage would be determined on a case-by-case basis). The difference between these payments, determined by the adopted formula and the interest actually due (if any) could be capitalised.

In order to stimulate growth, an additional 25% of export receipts could be set aside in a trust fund. The government would use this fund for productive investments, completion of priority projects and injection of capital into the private sector. In return for the reduction in debt service payments, the debtor country would permit the World Bank to monitor the allocation of the funds, as the World Bank has unique expertise in medium-term structural adjustment programmes and investment strategies.

But even such a "radical" scheme does not address the fundamental fear of some Sub-Saharan African debtors that, with their interest payment obligations growing faster than export proceeds, they will never "catch up." Reducing the rate of interest actually paid (by setting limits on the percentage of foreign exchange allocated to debt service – or even by arbitrarily setting the rate of interest at below the market level) may be desirable, but may not be enough for some debtors. For those countries, creditors – including banks – should consider cancelling part of the debt.

Today, a number of banks have actually written *down*, but not written *off*, a sizable portion of their credits to Sub-Saharan African debtors, but the countries continue to have contractual obligations to pay interest on the total amount of debt outstanding.

A write-off by banks for some countries would have to be reviewed carefully on a case-by-case basis, taking onto account the possibility of the debtor to further reduce imports, to adjust its economy and to generate additional exports.

To avoid an abrupt negative impact on the earnings of banks, regulators may have to allow an extended period of time for the banks to actually write off such loans. For debtor countries experiencing a sudden and unexpected increase in their foreign exchange receipts, a pay-back clause should be included to accelerate debt service payments to prevent the country from "windfall" foreign exchange gains.

For many Sub-Saharan African nations, further domestic adjustment – even where adjustment measures have not reached their economic limits – may be politically intolerable. Unless creditors express a willingness to share the adjustment burden more evenly and unless creditors act quickly, the price – in economic as well as political terms – could be very high.

Creditor countries and banks could be faced with situations in which the leaders of a government, no longer able to cope, would choose to repudiate sovereign obligations rather than risk his government's survival. Such a precedent could create a chain reaction among other debtors thus placing a further strain on the international financial system.

Creditor nations and banks would do well to confront this situation before it becomes unmanageable ●

Christine A. Bogdanowicz-Bindert

Senior Vice President of a major investment bank in New York City. Former economist at the International Monetary Fund in Washington DC. Mrs Bindert also teaches the course on international banking at the Graduate School of Business Administration at Fordham University in New York City.

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Mr. MOOSE. Mrs. Bindert refers and I think it is pertinent to the point that I am trying to make, to the need to examine the characteristics of debt rescheduling packages. Debt rescheduling packages need to be more realistic as far as Africa is concerned.

Rescheduling terms for Africa have typically been more stringent than those accorded to Latin American debtors and, for that reason, they have been inadequate in terms of the region's requirements.

Grace and repayment periods have been too short. They have been much shorter than they have for Latin America. Fees and spreads have been too high, and banks have usually resisted rescheduling anything but debt payments due in 1 or 2 years.

Now the problem is clearly a long-term one, and these annual rescheduling exercises that African countries are going through are just a revolving door: They really do not contribute anything. In fact, they usually make the problem worse because they invariably add more fees and have contributed very greatly to escalating the interest burden that these countries have endured, while the banks, in the case of Africa, have not put up any new resources.

I think at a minimum the banks and other creditors, including the official creditors, ought to extend the same terms and conditions to sub-Sahara Africa that they have extended to Latin American debtors, such as Mexico and Equador—multiyear reschedulings, lower spreads, no rescheduling fees, longer grace and repayment periods.

In this respect I am not asking for exceptional treatment to Africa but treatment more similar to that which has been accorded to the large Latin American debtor nations.

I think that banks, in addition, and creditors, need to look at the question of the actual amounts of repayments themselves, which are being made. The chairman got close to that in her question about the revolving fund. I believe the committee and the administration should examine ideas that have been put forward, in papers like that of Mrs. Christine Bogdanowicz-Bindert and elsewhere, relevant to some sort of flexible debt service payment, a formula that could be introduced to reduce the debt service burden.

Under a formula of this sort, a country might allocate, say, 25 percent of its receipts to debt service payments. Obviously the exact formula and percentage could be determined on a case-by-case basis.

The difference between these payments, determined by whatever formula is adopted, and the interest actually due could be capitalized. This is another idea, I think Niles Helmboldt will agree, is anathema to bankers, that is, to capitalize interest. After all, many observers doubt the capital will be repaid. As I observed earlier, much of it has been written off or down already.

One could go beyond that in order to stimulate growth to suggest that an additional 25 percent of export receipts be set aside in a trust fund for productive investments, priority projects, local costs, injection of capital into the private sector. In return for a reduction of debt service payments, the country would permit the World Bank and IMF to monitor the allocation of funds. In addition, some provision should be made to avoid a situation in which a country that had unexpected increases in its foreign exchange earnings

would get a foreign exchange earnings windfall as a result of this cap.

Serious thought should be given to these sorts of ideas which are considered radical schemes, as you could tell even by the polite reaction of the Deputy Secretary.

Finally, consideration must be given, I think, to reducing the debt stock of these countries in some way. There already is provision in U.S. law for forgiving official debt. Other countries have done it. Most European countries have forgiven debt to the poorest of the African countries.

There are ways to reduce debt without going all the way to forgiving the debt. One can convert debt to equity in various ways. It is complicated to work out schemes to do it. Or, one could allow writeoffs by banks over an extended period of time. As I suggested earlier, many banks are writing off some of this debt now, or writing it down. Notwithstanding that, the New York Times reports yesterday that banks are doing better than ever in their earnings.

Banks, the money center banks, are basking in profit at the same time they are really worried about this problem of debt. But they are not thinking enough in a creative way about how to work out of the problem.

The Secretary of the Treasury in testimony on September 22, is quoted by the New York Times as saying "if banks participate in this scheme, it will be because they find it in their self-interest. They have loans in trouble. It's like any other work-out situation: it's possible that reflows will make bad loans into good loans."

I think the banks need to work with this problem a little bit more than they had thought of doing in the past. Some of these ideas that I have suggested are anathema to my own banking colleagues, but I think combinations of approaches to the debt problem itself, to the stock of debt and to the amount of debt that is being repaid are necessary.

As I illustrated in the very real world case of Guinea-Bissau, a government can do everything in the world, and it is still not going to be enough, there isn't anybody who is going to lend them any money, so it is not going to make any difference. Something must be alone about the stock of debt and the amount of interest they must pay, in addition to doing all of the rest of these things.

I do appreciate the opportunity to come in here and to address myself to an area which might well be forgotten because nobody really likes to talk about it.

The comments that I read in the newspaper in the last couple of days concerning the administration's proposals have been really marvelous. The bankers are horrified by the Secretary of the Treasury's idea that banks ought to lend more money. On the other hand, some Members of Congress predictably, are saying that his proposal is just another scheme to bail out the banks. The banks somehow do not think so. There is a vast disparity in the ways in which different interests are reacting to this.

The issues that I have raised of the debt stock and the interest payments themselves touch sensitive areas that are hard to explore. But I believe they merit more consideration.

Thank you, Madam Chairman.

Senator KASSEBAUM. Thank you very much, Mr. Moose.

Mr. Wesson.

STATEMENT OF ROBERT WESSON, SENIOR RESEARCH FELLOW, HOOVER INSTITUTION, STANFORD UNIVERSITY

Mr. WESSON. Thank you, Madam Senator.

I appreciate the opportunity to be here.

I might say, however, that having heard the previous speakers give so much sensible advice and good ideas, I wonder why I might not just as well be in California playing tennis.

Senator KASSEBAUM. Well, on a day like this you might well wonder.

Mr. WESSON. I have submitted a little statement which I would certainly not feel it necessary to read or go into detail on. However, I could add a few remarks on the principal subjects that have come up here, particularly in the previous testimony.

One is that I think there should be a good deal more skepticism about the whole idea of conditions. It is hard to see what really new is going to be done except to accent slightly different aspects of conditionality, or the idea of putting conditions on loans or austerity programs, and so on. This has been going on for 3 years or more—a good deal more, actually, but for 3 years in a strong way. And it has had very limited success.

Countries will accept it in theory, because they will get money, and then they will fail to carry out the terms; and when they are carried out, frequently the result is not satisfactory.

So a new move to make additional help conditional does not seem to me to offer anything. One might just ask what is new, so to speak. We need to do something better than that.

The conditions that are proposed I think are by and large very sensible, but they are politically disadvantageous. One tends to forget the viewpoint of fairly self-respecting nations, which like to think of themselves as grown up. They are being told how they should manage their policies. Even if they agree and say yes, and they do so grudgingly, without proper spirit or without very much cooperative spirit. Perhaps even more important, it seems to me it associates good policies with the will and benefit of a foreign agency, and the enemy becomes the International Monetary Fund, or whatever agency is improving these conditions becomes a negative factor as seen by many people.

Furthermore, when they carry out or try to carry out or pretend to carry out conditions, then, when times get worse, the IMF gets all the blame.

I had a very nice little example of the President of the University of the Philippines, who a couple of days ago was saying how the IMF was largely to blame, in effect—he did not quite put it this way, but he passed the blame for the insurrection in the Philippines on the IMF.

Well, I cannot see that the IMF policies have had any such grave effect, or they have been so unsuccessful as to cause an insurrection. But it is an example of the psychology which is perfectly common with quite intelligent, educated, persons.

They see things in those terms. I regard this as sort of trying to command an adolescent, saying you have to do this or you have to

do that. It does not work, and they are likely really to think that the better thing for them is probably to do the opposite.

Well, I certainly would feel that the long run political costs of conditionality need to be considered very much more seriously. This does not preclude eduation. It does not preclude persuasion. You can point out to people: Look, you can handle things better if you do things thus and so, but it has to be voluntary to be effective.

The second point is that I am really puzzled that there would be any pretense that the proposals that have been made are anything like a solution. If the commercial banks are to lend supposedly $20 billion in additional funds over 3 years, I don't know what they would lend without the $20 billion, but that is additional, too, and it wouldn't be very much because they are trying to cut down as much as possible on their exposure. But a very elementary calculation is that $20 billion would be roughly 10 percent of the amount that is owed in interest for those same 3 years, the amount that will be coming due in interest. It is only a very minor fraction, nothing more than what has been going on for a long time, and it is very far from promising any real help.

I am not saying that if they loan a lot more money, it would really help either. It simply is very much in the bandaid category.

Then the World Bank is to increase its lending by some $3 billion a year. That sounds like an excellent idea. Great, if you can get good projects going with World Bank support. Fine. But, again, it is very, very far from anything like the solution to the problem.

Now I am happy that people have mentioned here the proposal that I put forward, particularly in an article of "Business Week," and I have written a number of other little articles about it—trying to treat the debt, in effect, as a sort of bankruptcy case, where there are certain funds available, and seeing how those funds can be used for the ultimate of benefit of the creditors.

The fundamental idea, it seems to me, is that it is not practical, it is not desirable, even to try to extract the money from the countries that owe it.

The only way that one can come close to hope for eventual liquidation of the debts—and I would like to interject that I strongly feel that cancellation or forgiveness is undesirable; it would be very difficult and unfair—the only way that the debts can be made payable is by keeping the money in the country concerned for more or less time as is feasible in a productive capacity. This goes back to the basic trouble, which, of course, is that banks started out lending large sums of money to governments without collateral.

This is something they never should have done in the first place. But it seemed like awfully good business, easy and attractive, with so much going for it on the books, and so on. But it is not good business, and anyone who has studied the politics of the Third World I think would be convinced of that.

They should have asked some experienced Latin Americanists or Africanists about it, and I think they would have come up with the idea that it just simply was not desirable to pass out money which you can expect politicians are going to accept because they personally do not have to repay it.

However, it is possible to transfer resources out of these countries. Money is payable. Profits have been remitted for a long

period of time, but there have to be profits. One cannot put governments in the position of taxing their countries very heavily to pay large sums yearly to foreign creditors. They just cannot do it in a democratic society. They cannot really do it in a nondemocratic society either.

It is as though the Congress of the United States were asked to budget $300 billion a year to pay debts to Japan—and maybe we will owe Japan that much money one of these days—when there is so much else that they need the money for. The money is desperately needed for all kinds of things at home.

While it is true that Mexico and Brazil, for instance, have paid very substantial sums of money, obviously they are not willing to go on expending roughly half of their total export earnings simply to pay creditors, unless they are going to get back much larger sums in new loans, thereby aggravating the problem.

This does not mean that money cannot be gotten out eventually. But it can only be by putting the money concerned into productive enterprises in the countries concerned through whatever mechanism or variety of mechanisms can be imagined to do that.

Beyond that, there are a number of other things that imagination might suggest. One is trying to take more or less payment in goods from countries. You are probably familiar with the fact that Peru settles a considerable part of its debt to the Soviet Union by sending them frozen chickens, textiles, canned fruit, and other goods.

I spoke with a man at the Peruvian Embassy, and he was enthusiastic. He said if you give us a chance and let us do something like that, we would be happy to do it.

Well, the banks have not taken up that in principle, but they are not getting anything from Peru otherwise, and I think they would be very well advised to consider something like that. It puts Peruvian industry to work, helps employment, and keeps something flowing where otherwise there would be nothing.

There also are obvious possibilities of relating trade among debtor countries. One of the ironic conditions of the debt situation has been that countries have been pressed to cut back their imports so that one debtor country cannot import goods from another debtor country, thereby hurting the economies of both. It should not be difficult to make arrangements to give credits or to work it out so that money would come back in part to the banks in return for encouraging trade of that kind.

The African debt, of course, is largely public debt, in contrast with the Latin American, although I think that the amount of private debt is larger than has been alluded to here. Perhaps I should not say that because I am talking with experts. But obviously there is a great deal of uncertainty about how much the debt actually is. There seems to be a good deal floating out there, I take it, of private debt, which is not adequately accounted for.

Dealing with the public debt is a matter of public policy, and I would like to put in a pitch for trying to use it not to bail out Governments or bail out banks, but to turn it into human capital.

I am very skeptical, generally speaking, of loans to Governments in any case, and loans that simply help to postpone problems are not ultimately productive. But there are tremendous needs, par-

ticularly in health, education, and infrastructure where, if the creditor Government could take more or less what is owed and accept payments in local currency to be applied under controlled conditions to these purposes, it seems to me that would be a most promising way of building up the economy and ultimately making the situation manageable.

The plight of Guinea-Bissau, mentioned most eloquently here comes to mind. The only way that Guinea-Bissau is going to come out, so to speak, is by a development of the whole society. We would like to say that a country like that should adopt the proper policies so that capital will flow in, but capital will not flow in unless there is a real prospect of political stability and the kind of work force, atmosphere, and so on to make it profitable. Guinea-Bissau could not become another Hong Kong simply by adopting different policies.

But I do not think that the people of Guinea-Bissau are less capable ultimately or genetically, and if the United States and other countries can cooperate to help to—I don't know just what word to use—to modernize that society, ultimately I think we could see the results that we hope for.

At any rate, the basic idea would be that the creditors have a very large lien on these countries, and the countries have a remarkable willingness to try to pay. I think that with thought and imagination, that lien could be converted to real benefit for them and ultimately for us.

I thank you.

[Mr. Wesson's prepared statement with attachment follows:]

Prepared Statement of Robert Wesson

The Third World debt problem, principally Latin American and African, clearly seems to be moving toward a crisis. More and more countries are getting farther into arrears, or pay interest only when more or less covered by new loans--it is taken for granted that amortization of principal is restructured. Loans get harder to arrange, and the ability and incentives to pay decrease, although countries keep contending unrealistically (only to keep credits coming) that they will pay someday. New loans only postpone the problem a little while making it bigger. Numerous defaults are avoided only because banks refrain from calling spades spades. The Mexican earthquake has brought a showdown closer, and moratoria are increasingly in vogue. Repudiation is sure to become a big political

cause if present conditions continue. Sooner or later, there is danger of widespread non-payment, clamor for writeoffs or forgiveness of unpayable loans, and potential disaster both for the leading banks and the international financial system.

Much of the Third World is in a grave depression, which is worse because it is self-reinforcing. Because of the debt burden, and uncertainty about the economy and to some extent the political outlook, there is little new investment, and capital prefers to go abroad. Yet no real recovery of the affected economies is possible without a return to high levels of investment, both national and foreign, and the repatriation of capital sent abroad since 1981. This is not to be expected until the foreign indebtedness afflicting African, Latin American, and various other countries is brought under control.

This will be a long and difficult process at best. However, it should be possible to make a start immediately toward providing new capital while reducing the burden of debt service. This could be achieved by permitting debtor nations to cover an agreed fraction of their obligations in national currency at an equitable rate of exchange. The question of exchange rates would have to be negotiated in countries where rates are controlled, but there is usually a more or less free rate, which commonly undervalues the local currency because of capital flight. Inflation is a problem all holders of

national currency have to face, but they are generally able to profit from high real interest rates. Payments in local currency would be made into a fund or funds held and managed by the creditors. This fund would be applied to new productive investments in the debtor country, in agreement with the government concerned.

The idea sometimes mooted of banks taking over existing enterprises in payment of debts is not politically acceptable; it would mean simply handing over a large part of the economy. New investments, however, would generally be welcome, especially if export productive. They might be made in partnership with outside venture capital, with advantages of bringing in needed management and technology. It might be alternatively possible to arrange for outsiders to contribute import needs in dollars of projects while the debt fund covered local costs. Presumably banks would be free to sell their shares. So far as feasible it would be desirable to associate local capital with enterprises, or to have the national government join in a minority share to increase incentives to make the plan a success. Profits would be remittable after an agreed period, much as debt is being stretched out to a dozen years or so, or be paid in exports. Although it is not politicaly feasible for the debtor countries to turn over going concerns to the foreign interests, debt funds could well be applied to the rehabilitation of ailing businesses, including financing of the privatization of unprofitable state enterprises.

There should be no difficulty in finding suitable investment opportunities. Most Third World economies have for several years been starved of investment capital, as capital has preferred to go abroad and new lending has been drying up or has gone unproductively into payments on old loans. In Africa, the greatest need is for the rehabilitation of agriculture--especially, for example, in Nigeria, which badly neglected agriculture in the petroleum boom and now has to readjust. In various countries, petroleum exploration is called for in hopes of reducing oil import bills; infrastructures have become rundown; and so forth.

Such a reinvestment scheme should be attractive for debtor nations. It is, of course, much less onerous to pay in national currency than in dollars. The new investment would help combat the scourge of unemployment, and in due course it should improve government revenues by stimulating the economy. It would enable the debtor nations to maintain their credit standing and self-respect, avoiding breaking with the ethics of international business. It would also reduce their excuses for nonpayment and blaming the capitalists and financiers for their troubles. Indeed, it might be possible to offer countries currently paying little or nothing--which includes most African countries as well as several in Latin America such as Peru and Bolivia--the facility of paying something for investment in the country, thereby to return to international financial good grace.

Various countries might balk at the increase of foreign ownership in the economy, but if the program proved successful in some countries, others would find it hard to refuse cooperation.

Although unconventional, such a procedure should be acceptable to banks, because it would leave them with sounder assets than the current practice of financing a larger or smaller fraction of debt service payments by new loans. Through investment, the banks would acquire control over the application of their assets and have better prospects of eventual recovery of amounts loaned. It would mean putting the money where it should have gone in the first place, into productive undertakings instead of largely covering government deficits and losses of state enterprises. It would make the banks in effect partners in the development of the nations whose development is essential to them. It would also cause the countries concerned to increase the share of their product going into useful capital investment. Not least, conversion of as much as possible of the debt into new equity would also permit reduction of the debt burden instead of steadily increasing it, as current restructuring does, and would stimulate instead of depressing the economy. Arrangements might be somewhat complicated, but the scheme of bridge loans, reschedulings, and so forth is complicated also. Details might be varied subject to human inventiveness while fulfilling the essential, keeping capital usefully in the needy country.

Conversion of debt into equity in this fashion might be supplemented or accompanied by other programs. For example, arrangements could be made to accept partial payment in national manufactures, goods that could be bartered or sold in ways not competitive with U.S. exports. Debt payments could also be coupled in various ways with trading arrangements among debtor countries and with the United States. Thus, facilities might be given for imports from debtor nations of materials needed for export production in other debtor nations. There should also be possibilities for joint undertakings by interests in different debtor states, increasing their exchanges and productive capacities.

Such schemes would not be ideal for banks, which like nothing so well as cash returns, but they would be far more promising than waiting for the system to break down under the ever-growing load of debt. Since August 1982 there has been much talk of the crisis having been mastered, if not solved, by the numerous renegotiations or roll-overs, and new unsecured loans to keep up payments on old. These have been accompanied by "austerity programs," designed to give an impression that the problem arises from bad policies of the debtors and that steps are being taken to make repayments possible. But while Mexico was being praised as a model debtor, its outstanding obligations increased by $10 billion.

The idea that the problems will be cured by a new austerity

program is fatuous. The prescriptions for economic health have seldom been seriously applied, and when actually applied they have not worked. Basically, they are bad psychology, and governments implement them unwillingly. They are patronizing and make probably desirable and mutually beneficial measures into prescriptions of a disliked agency for the benefit of foreign interests, by implication to the detriment of the nation. They are usually seen as insensitive to political and social needs, and they make a good target for economic nationalists and politicians.

Conditionality, however ineffective, is an excuse or rationalization for extending new loans, which have the great virtue of postponing the problem and at the same time helping American exports and providing foreign money to purchase U.S. Treasury certificates. But as the prospects of eventual repayment fade, the banks become less agreeable to extending new loans that obviously cannot be paid, and the debtors become less willing to stretch themselves to make payments on old ones. Both sides should acknowledge the obvious fact that the debtor nations are not going to be able or willing to pay in the sense of transferring large net amounts of capital in dollars to the creditors. That is, the pretense that there is a liquidity problem should be dropped, in recognition that there is a solvency problem. Banks should act on this reality, even though they may not be prepared to acknowledge it, that the amounts borrowed cannot possibly be squeezed out of the Third World

economies. For many countries, payments due are roughly equivalent to the burden of the United States paying to foreign creditors in foreign currency some $300 billion dollars per year--and much more difficult for poor countries with less effective governments.

The situation should be approached in the same spirit as a domestic bankruptcy, with negotiations to determine what can be salvaged for the creditors, within the limited capacities of the debtors. A huge amount of money has been lost because of poor management or corruption of some kind on the part of the debtors, lack of caution and foresight on the part of the banks, and circumstances beyond anyone's control; and equity requires that the losses be shared. Simple writeoff, as some have suggested, would raise many problems. The debtors and creditors alike have a compelling interest in a fair settlement that will permit economic recovery.

The U.S. government should cooperate actively in the resolution of the debt problem. It bears moral responsibility for having encouraged feckless lending policies for reasons of short term economic and political advantage. The government also has an interest in the economic revival of the Third World for the sake of promoting exports. It has a strong interest in the health of the private sector in less developed countries, which is endangered by economic stringency and political uncertainty but would be helped by a reinvestment program. It has an even stronger interest in stability, democracy, and friendly

relations with Third World countries, all of which are seriously threatened. It is difficult to envisage any settlement without the cooperation, preferably the leadership of the United States, acting both on its own and through the IMF and the World Bank.

Many things could be done, from relating treatment of debt to concessions for Third World exports to modification of banking rules to facilitate banks' investing debt payments in the local economies and applying foreign aid in ways to assist debt management. The U.S. government, a major creditor, might well take part payment in national currency, as was done long ago with food aid, perhaps making investments in human capital (education and health) for a long-term economic and political return. In sum, resolving the Third World debt problem should be a major foreign policy objective of the United States, not only for selfish economic interests, but for broad political reasons, deserving of attention along with security in the Near East and so forth.

The debt morass represents a major calamity for the debtors, and it may become much worse and turn into a political crisis. It should be possible, however, in a spirit of compromise, to reach reasonably satisfactory solutions, perhaps even strengthening rather than disrupting commercial and political relations with the United States and their creditors. It is a challenge to imagination and statesmanship.

NOTE ON ADMINISTRATION PROPOSALS REGARDING THIRD WORLD DEBT PROBLEM

Robert Wesson
Hoover Institution, Stanford University
October 24, 1985

It is welcome that the Administration is giving attention to the grave problem of Third World indebtedness, but the proposals as publicized are not promising. There are reportedly three aspects:

1) Persuading commercial banks to lend some $20 billion additionally over the next three years. This may encounter some difficulties, as the likelihood of repayment dims. The amount is not sufficient to help very much, as interest due over the next three years may be estimated at nearly time times this amount. It has the shortterm value of helping to keep up U.S. exports and also capital flight into this country.

2) Encouraging the World Bank to increase lending by several billion dollars. It is not clear where this money would be found unless governments are willing to increase the capital of the World Bank. If loans are so controlled as to make sure resources are productively applied, it would be an excellent idea. If more funds were merely made available to governments, the long-term utility would be doubtful.

3) Making new loans conditional on acceptance of certain policies by debtor countries. These policies are various, but three are most mentioned: privatization of state enterprises, ending of price subsidies on necessities, and fixing favorable conditions for foreign investment.

Privatization is inherently desirable but difficult, mostly for the same reason that makes it desirable, the usual unprofitability of the state enterprises. Also, local capital is not adequate or eager to take charge of major state activities. It is, moreover, highly undesirable that reduction of the state sector should appear as the demand of foreign interests, therefore to their benefit and by implication to the detriment of national interests. Perhaps

assistance could be given for this purposes, which is widely (although not universally) recognized as desirable in the debtor nations, but it should not be a demand from outsiders.

Subsidies for necessities are politically and socially important in poor countries generally lacking welfare programs and unemployment insurance. It is probably damaging for the foreign agency to make an issue of them; at least, it appears as budget-balancing for the benefit of foreigners at the expense of the poor.

It is undoubtedly desirable for debtor countries to welcome foreign investment, but the same reservations hold as to the political costs of a foreign agency pressing a policy for foreigners, and it certainly does not guarantee a warm or permanent welcome for foreign capital. Not less important, no matter what laws or regulations may be passed, not much investment will be made until the economic climate is favorable, and this cannot come about without substantial investment.

Broadly speaking, conditionality serves mostly the psychological purpose of offering some reassurance to creditors, while commonly proving offensive to debtors. In any case, no one has a good blueprint for policies guaranteed to bring a rapid rise of production and prosperity even in the First World, much less under unfavorable circumstances in the Third World.

In sum, the proposals mooted might help somewhat to postpone a crisis, but they offer no ladder to enable countries to climb out of the pit of debt.

Senator KASSEBAUM. Thank you very much, Mr. Wesson.

I hope all of you will feel free to ask questions of each other because all four of you are far more expert than I am in this area.

I would first like Mr. Helmboldt, to ask you, what you as a banker think of the suggestions you have heard from both Mr. Wesson and Mr. Moose about some means of dealing with the debt service, whether through a revolving fund or a trust fund or by capitalizing the interest in some way.

How would you regard that when you look at your own debt that needs to be collected?

Mr. HELMBOLDT. Mr. Moose and I are both bankers, but I have a huge African exposure and I think he does not, so he is sometimes more able to make these suggestions than I am.

But I would point out that there has been some considerable wisdom on these points from this side of the table [indicating] from my colleagues.

As the "bravest" bank, I guess, if we are such, I can tell you that we are already using all of these solutions ourselves as a way of doing business in Africa. We do business only in Africa. Therefore all of our profits and our increased exposure goes right back into these countries so each of the countries with which we deal understands full well that, when they repay us and service their debt with us, it comes right back in again with new projects, new trade transactions, and so forth. So there never is a net reduction in Equator's exposure in Africa. As a result, Africa views us somewhat differently in terms of addressing this problem.

Although we have not yet taken frozen chicken, we do have a trading company subsidiary of the bank set up in no small part to give us the capacity to take goods in return, so that we can work on individual transactional solutions by being able to take African exports or move goods between African countries and, as a result, generate the repayment of the facilities that we provide.

The area of absolute forgiveness or debt reduction is a sensitive one. In reality, much of this really is going on today because debt obligations of African countries do change hands between foreign parties holding this debt at a discount, so the holder is accepting a certain reduction in the value of the debt in keeping it on his books. In some cases the African Governments, themselves, are the ultimate repurchasers of these reduced value obligations, so that they effectively are accomplishing a reduction in their overall debt service through this mechanism of buying back at the market rate the obligations that they already have.

I think, in speaking earlier about applying bandaids, it is not a bad metaphor because bandaids can be put on by everyone. Surgeons, of course, have to do the more complicated operations. I think that the approach that has to be taken to the various issues is going to have to be tailored very carefully to each of the individual countries.

Many have a domestic economic base which can, with some additional sustenance, repay the obligations, and therefore they can be treated on a more normal basis.

Guinea-Bissau, Dick's example, and other countries which are so desperately poor, obviously have no immediate or even long-term capacity for significant reductions. They are few, these countries,

and they tend to have very small absolute debt obligations, which have to be dealt with much differently than the larger ones, such as Zambia's, Nigeria's, Zaire's, that of the Ivory Coast and other countries that have an economic base, existing activity, and a capacity to effect a reduction on normal commercial terms.

Senator KASSEBAUM. I was interested in your comment on privatizing the parastatals. I wonder just what would be the best mechanism to do this.

Is this something one could do using a fund that would put back in repayments for capital use? Can one do that? Can one use such a fund or maybe even IMF or World Bank credit, to assist in privatization?

I am thinking, say, of co-ops. Our farmer co-ops were aimed at getting the agricultural community to work together, and they were always private. Co-ups are state-run in many African countries.

Mr. HELMBOLDT. I think that the prerequisite to privatization is the acceptance on the part of the host government of a realistic value to the parastatal companies in today's terms.

To date, I think that most efforts at privatization have failed because the governments have attempted to retrieve the entire investment value that they put into these companies both in terms of the original capital investment and also the ongoing subsidies, in terms of working capital investments made after the initial investment.

I have seen successful privatizations where considerable write-downs were accepted by the host government in exchange for the revitalization of an economic activity which created employment, created exports, and so forth. The discount has to be substantial.

Using a trust fund approach for it presupposes that the holders of the debt are willing to convert debt into another kind of instrument at a given point in time. I don't believe that time has yet been reached, and I think one of the problems with that approach today is that the banks dealing with these questions have not finally decided what debt treatment they are willing to accept. I believe it will be some time before it will come.

Senator KASSEBAUM. Thank you.

Mr. Dale, did you have a comment?

Mr. DALE. Well, I was going to say it a little more generally, Senator.

I think all kinds of ideas, such as those cataloged by Christine Bindert—who, by the way, used to be a Fund staff member, and we were very unhappy when she went to New York to make her fortune. She was the Zaire desk officer a few years ago. But these ought to be looked at, and they ought to be looked at sympathetically and imaginatively. They ought to be looked at realistically and in terms of all the elements of the ideas.

Now I get very much the impression that Equator is a very special kind of bank, and it may be special, I am not quite sure, in terms of its own ownership arrangements.

But when you have banks that are fully privately owned and are being told by the U.S. regulators for good policy reasons to increase their capital, and a lot of these ideas are telling them effectively, one way or another, to write down their foreign exposure, I think

you have very real policy conflicts. You may succeed, inadvertently, if you are not careful with these ideas, in getting less money into the developing world, rather than more.

So I think you have to look with a lot of sensitivity to all the elements of the problem when you are looking at these more radical ideas.

I do not hesitate to look at radical ideas. But we have to be sure we know exactly what all the implications are going to be, particularly for the objectives in mind, namely the developing countries themselves.

I think that, unfortunately, is not very often done.

Maybe you won't mind if I say I have discovered $540 million or $90 million a year that had not been referred to earlier in this hearing. The $2.7 billion of Trust Fund reflows is not $2.7 billion. It is 2.7 billion SDR's. The exchange rate does not effectively apply over a 6 year period. It is, of course, a matter of guess work. But, if you apply the old, historic dollar-SDR exchange rate, you gain an additional $90 million a year which, in this situation, in Africa, is no small amount.

Senator KASSEBAUM. I would like to ask you, Mr. Dale, what you think of the Treasury's new focus on coordination between World Bank and IMF. I am not quite sure if this is an idea still aborning or exactly where it stands.

Mr. DALE. I think it is, as far as I understand it.

Senator KASSEBAUM. Well, I think it is, too. But I wanted to ask about the implementation of it and if you feel such coordination could be useful.

Mr. DALE. Yes, I think it can be a very useful coordination.

I think it ought to be taken to the furthest degree possible.

A lot has been done over the years in Bank-Fund collaboration, and that was something that I was directly involved in when I was still at the IMF, particularly in the period since about 1979 or 1980, when, on both sides of 19th Street, it became more and more completely recognized that the problems all of these countries, particularly in Africa, were facing were longer term, had a very heavy structural element in them, and that with the World Bank creating its Structural Adjustment Lending Program and the Fund stretching out its maturities and becoming more cognizant and concerned about structural policy elements of its programs, it was inevitable that the two were going to be working in each other's back yard if not front yard. This is because their approaches to the problems interlinked, necessarily.

The U.S. Government—whether Treasury or State I am not quite sure as to its origins—the idea of fully joint missions and policy conditions is again something that ought to be looked at and I do not much hesitate about it, except that, well, you people up on the Hill have a lot of experience in coordinating with what you call the other body, and you can imagine that there are very real differences in views, philosophies, and approaches to problems that, no matter how hard you try, you cannot just wish away.

One of the problems with joint missions or joint conditionality, for example, is a very simple managerial question—who is in charge? If you are going to have joint missions, eventually somebody has to be in charge. Is it going to be a World Bank person,

who is responsible to the president of the World Bank? That's fine. Maybe that's the way it should be. But you have to reckon that there will be practical consequences of choices of that sort being made. I think it is those very practical, managerial issues that have to be looked at.

Senator KASSEBAUM. If I may, I would like to take an example which is not Guinea-Bissau or Mozambique, which are special cases unto themselves. Let's take Sudan, which is our largest aid recipient in sub-Saharan Africa. It is in the midst of some political turmoil, although it is under leadership now which is saying that it hopes to hold elections in April and which seems to be trying to pull the various factions in the country together.

Does Equator have a bank in Sudan?

Mr. HELMBOLDT. Senator, I pride myself on knowing a good deal about Africa, but Sudan is a mystery to me. We do some business there, but I find it very hard to understand.

Senator KASSEBAUM. I guess I picked the wrong country to try to analyze.

Well, something that I would like to ask both Mr. Moose and Mr. Dale—and I should know this—is the following. Having been at State and having been at IMF, what coordination is there between State and IMF and the World Bank as far as aid, whether for security assistance or developmental assistance, and lending that is taking place through IMF or World Bank or any private banking institution?

It seems to me that as you get into some of these really disastrous cases, the hope certainly is there and the potential has existed before, but it may take some very dramatic efforts at coordination, which we have had an awfully hard time putting together.

I would like to hear what your analysis would be.

Mr. MOOSE. In the old days, when I was in Washington—and I understand things are done much better now—there was not very much coordination at all that I was ever aware of. There was enough problem with coordination between State and AID to begin with, but between State and AID as a U.S. Government collective on the one hand and the IMF and the World Bank on the other it was almost unheard of.

That may overstate it, but it was minimal.

I think that is somewhat changing now. But that was my perception of it at the time.

Your question gives me the opportunity to say one other thing that I think is very important because it edges up on the question of donor coordination in general. I think this is a very serious problem.

There is a really interesting study that was commissioned by the OECD recently which was led by professor Robert Cossen at Sussex University in England. The results of his study will be released soon. It documents the most appalling situations that arise from a lack of coordination between donors.

I do see some signs in the things that we do of State and Treasury trying to work more closely with the Bank and the Fund and trying to encourage the Bank and the Fund, whose staffs have talked a lot more about working together. I see some progress there.

Senator KASSEBAUM. Is that wise? I mean, can it be done? Should it be done?

Mr. DALE. Oh, yes, without any question.

Actually, I disagree with Dick a little bit on history.

First of all, the requirement for coordination in years gone by was clearly much less than it is now. But I think the degree of coordination, while not organized or formalized or anything of the sort was a little better than he indicates.

Of course, I should declare my bias. Before being Deputy Managing Director of the Fund, I was for eleven and a half years the U.S. Executive Director of the Fund. Coordination between U.S. agencies—State, Treasury and AID mainly—and the IMF funnels through the office of the U.S. Executive Director. We have lots and lots of meetings, many more now than used to be the case. But they have lots of meetings for the sharing of information in the first instance, which is the initial basis of coordination, and then to try to agree on who is going to do what in connection with the ongoing program.

I agree that this has improved a lot in recent years. One of the reasons it has improved is people find it necessary for it to improve and the necessary manpower—and don't underestimate the requirement for manpower; it is a very manpower intensive activity—is being given to it.

Mr. MOOSE. May I just interject something?

Would you agree, if I were to slightly amend my statement and say there were instances, specific countries, in which there was a deliberate effort made at coordination——

Mr. DALE. Yes.

Mr. MOOSE [continuing]. If you had a consultative group or something of the sort, there were some successes there.

Mr. DALE. Yes.

Mr. MOOSE. But in the sense that USAID or the State Department might consult or get any particular guidance from the Bank or the Fund as they were drawing up their own program or choosing their priorities and directions, that was the sense that I thought of when I answered the question.

Mr. DALE. It gives a little slant on it, on what did not necessarily always happen.

Senator KASSEBAUM. I was thinking, for example, in the case of Sudan, that it would be very helpful if you could take what AID proposes and the requests that come from the Government about what they want—it is not always a case of our suggesting; many times, as you know, they suggest what they believe they have to have—and see how these fit with the rest of the efforts that are being contemplated.

Mr. MOOSE. The case of the Sudan, is an interesting example. You are absolutely right to look at that one more closely.

I was Assistant Secretary of State for African Affairs from 1977 through 1980, the end of the Carter administration, during a significant part of the buildup of debt in the Sudan. As I have thought back on that process since, I really marvel at what happened.

Sudan was considered then to be a country in which we were particularly interested. We, the United States, were always vitally interested in Sudan. We always inserted that adverb or adjective.

It was a vital country. It supported Egypt and its moderate approach to the peace process and had all sorts of dangerous characters on its flank, down below it and to one side and the other. Sudan had great promise and was to be the "bread basket of the Middle East." We used that phrase a great deal.

It was a hot place and we would give it military assistance, and oil had been discovered and it was going to be developed, and the desert was going to be green.

I went two times to the annual meeting of the U.S.-Sudan Business Council. I would get up as Assistant Secretary to blow the horn and beat the drum for what a great place Sudan was, to try to get more American companies interested in there, to get the banks to come and do everything. Everybody got hyped about Sudan. And, besides, there were always the Saudis behind them and who were going to bail them out—or so a lot of people, including the Sudanese—thought.

It did not happen. Anybody who was wiser, looking at it and watching the process, would have known it was not going to happen the way people imagined it would.

Suddenly it just began to go bad. The internal problems that brought reality to the picture. Everybody then said well, wait a minute and let's take a look at this thing. Just what is it?

Well, if they would have looked that hard at it in the beginning, they would never have done what they did in the first place.

It was out of control. All of the various companies were in there, competing to do things. There was a brisk competition.

I mean, you do not have a real commercial bank here (in Equator) in the sense of the ones that I am talking about. That is banks that have really large loans there because Niles Helmboldt's bank is different. It is a real bank, of course, but I am talking about the big money center banks. They have a special perspective on this. You don't have that perspective represented here.

Senator KASSEBAUM. I think we need you out in Kansas, for our farmland. [Laughter.]

I remember President Numeri being here not long after I took over the subcommittee, and, at that time it was oil that was going to be the real salvation and source of growth in Sudan. It seemed very reasonable.

I cannot help but think of ourselves and the enormous amount of money we put into synfuel development, for instance, with a whole town created in Colorado on the basis of what was to be. It is not that that still is not going to be very important, just as oil may well be in Sudan; but our hopes always escalate beyond the reality, I guess.

It is as you said, Mr. Wesson, how much can we, through Government policy here—and we have not always done such a good job—try to tell someone else what they should do? It is hard to devise, it seems to me, the qualifications and the conditions that have to be met in order to qualify for the loans.

It is essential in many ways. I don't know whether there is any other way that we can bring about reform, which is important. But it does have to come internally.

I very much think it is a process of cultivating and working with the leadership there, with the management, so that there is a base

of development there that recognizes the importance of the private sector. It cannot just be the president and prime minister.

Mr. MOOSE. I agree with that very much. One cannot be against reform any more than one can be against motherhood. But there are limits to what can be done and to the expectations that should attach to that.

It is terribly important for administration witnesses to come up and to emphasize reform because that is a way that they have of giving Members of Congress something with which to protect yourself if you think what they have said is sensible. You you will then be able to say after all, "these people are reforming themselves and so it is alright."

This is one of the reasons why I am interested to see the creditors get into a little bit of the reform action and the burden-sharing themselves. I think you can only go so far with reform.

I have seen a number of instances recently—and instead of seeing people in foreign ministries now, I tend to talk to people in finance ministries and in the central banks—I see lots of instances in which I think the processes and the personnel required to implement reform simply are not there. I don't see so much real resistance to reform and liberalization on the grounds of logic or ideology. In lots and lots of places, I see an enormous incapacity to implement those reforms; to understand what is really involved and what is entailed.

I don't see any resistance, for example, on the part of the Government of Mozambique to these elements of reform. But I see that they have a very limited idea of how to begin to put a market economy into operation—free prices, liberalization of foreign exchange allocation, privatization and all of that. How do you do this if for 500 years you were the poorest colony Portugal, or one of them, you have been independent for only 20 years, under a Marxist Government—an ineffective one, but Marxist nevertheless. They make no bones about it, and it still is Marxist. All of a sudden, now, they are supposed to liberalize, to open up, to reorient. They join the Bank, they join the Fund. They take the price controls off their tomatoes, and suddenly there are lots of tomatoes. It's amazing, it works. But it's a little bit more complicated when you get beyond the central produce market in downtown Maputo and wonder about how do you liberalize the entire economy.

They are willing to do it, but how do they do it? You don't do it quickly.

Senator KASSEBAUM. That's true. You don't do it quickly.

What would you suggest? Would you suggest patience and perseverence on our part?

Mr. MOOSE. It will take a while.

Mr. HELMBOLDT. Then, too, there has to be a response, because there is no doubt in my mind that the efforts are sincere, and there is an expectation that there will be some immediate reciprocity, however small, to validate the process that they are trying to initiate.

Senator KASSEBAUM. Do you mean in Mozambique?

Mr. HELMBOLDT. In Mozambique, or Zambia, or anywhere else where there are policy reforms. This is because there is a high political risk in policy reforms. Before decisions are made, leaders

want to hear the rhetoric in the marketplace: What will happen if we do this, if we free prices, if we encourage this or encourage that, and nothing happens. That, unfortunately, is what is going on right now. Nothing is happening. That is why I keep urging the band-aids. There is not going to be a long period of willingness to wait for trial and error.

Mr. DALE. You have a window and you had better take advantage of it. I agree with that.

I think there are two very interesting cases that ought to be looked at that have been so far pretty successful: Ghana and Somalia, for several years. They were both cases where Marxist Governments, or left-wing governments, anyway, convinced themselves. Here I think the will for reform was pretty much homegrown. It was helped by the Fund, by the Bank, and so on. It really worked remarkably well.

In Ghana, I thought they were extremely inventive in dealing with the political issues of the exchange rate, which had been a no-no and a very high risk political issue for many, many years.

Mr. MOOSE. It brought down a couple of Governments and killed several people.

Mr. DALE. Yes.

Senator KASSEBAUM. On that note—[Laughter.]

Mr. DALE. Yes, but that was before. I'm sorry, Dick, let's get the story straight. [Laughter.]

Senator KASSEBAUM. Well, I realize, of course, that it has unfortunately taken that turn in many countries.

Let me ask if any of you have any other comments you would like to make?

Mr. HELMBOLDT. There is one thing I would like to say, Senator.

One area where I certainly did disagree this morning with the speakers who preceded us is the idea, which sounds to me quite out of date, now, that somehow it is the fault of the U.S. Government, the fault of the World Bank, the Fund, and other people, that these situations have arisen and that initiatives which are highly concentrated and driven from the outside are going to make a difference.

I simply do not see it that way.

I think there has to be a fundamental willingness on the part of the individual country to engage in these reforms and to experiment in change. I see it very much in terms of a pull from the African side, of going out and looking for things that can be done as solutions, not sitting back in Maputo or somewhere else and having a mission come in and tell them how it is going to be done.

I think it is vital that we do not blow a second chance now by cramming all sorts of advice and all sorts of packages down the throats of countries that have not yet decided how they want to come out and look for these kinds of responses to their changes.

Senator KASSEBAUM. I could not agree with you more, and I sense that you are a bit frustrated in the case of Mozambique. Is this what you were implying, that we have not been more receptive enough there?

Mr. HELMBOLDT. I wasn't really implying anything. I simply used it as a good example of an economy and a nation that had made quite a substantial change along the lines that we seem to be trying to encourage by the things that we are doing and saying.

Senator KASSEBAUM. I think that is true, and I think the administration has tried very hard to be responsive there. Congress has been more reluctant and, I think, has wanted to wait and see what changes are actually made. That is often the political sense that comes into play here in Congress.

Did you have something to add, Mr. Wesson?

Mr. WESSON. I would like to make just a little remark. It is very encouraging when one sees countries that recognize that things have to be done differently and are willing to undertake a radical turn. The case of China is an example of the ability of some people there to see that things were going in the ideological way very badly, and to turn around and be, in effect, pragmatic, and they have had enormous success. But it has to be something that they are going to see and want to do on their own. When someone says you've got to do this, that rather tends to get people's backs up and it puts the whole thing under a handicap.

Also, I would like to note the question of privatization of State enterprises which is central, really, to the consideration of the debt problem because State enterprise has been the cause of a great deal of trouble.

But it is very difficult. How are you going to privatize enterprises that are nonfunctional, that are losing money very badly? Nobody wants to buy them and the Governments don't want to get rid of any State enterprises that are making money. Far from it.

Even worse is the fact that they are employment generating activities. They are part of the whole system whereby the Government acts as the means of employment of persons who have the qualifying education. That is accepted, in effect, as an obligation of Government, and the State enterprises are staffed by persons who are, to a very large extent, incompetent, but with a very strong interest in their jobs and frequently with a lot of political pull.

So, to push for their privatization is very difficult for someone from the outside, and I am not sure that it is likely to work out unless they, themselves, can be so strongly convinced that they have to do something differently.

I would like to suggest that a better approach, at least in many cases, might be not trying to say, turn your State enterprise over to private business, but open up the field to competition and allow competition to the State enterprise. Then the State enterprise possibly may shape up. If it does not, it can go on and it doesn't matter very much. But it is very much more politically feasible, it seems to me, to proceed in that direction than in the other.

Let me make one additional little remark.

A speaker this morning, I believe Mr. Whitehead, said that the question of banks taking local currency to set up an investment fund would be a matter of individual decision. Well, I suppose it would, to some extent. The matter of making loans is an individual decision. But general policy has a great deal to do with it and there is a great deal that the American Government has done toward directing policy in regard to making loans and is trying to do now by some strong arm twisting of banks to make additional loans. If the American Government saw the advisability of something like that, it would be of tremendous help to the banks to make a decision in that way.

I believe that Mr. Moose, or perhaps Mr. Dale, said that the banks were not ready for undertaking radical measures or for really looking at anything in a very different light, and my question certainly would be if they are not ready now, when are they going to be ready? I hope they are not going to wait until the crisis really is strongly upon us, when the countries are in arrears even worse than they are now, and the idea of paying the debt comes to seem fairly far out and the whole system is on the verge of breaking down.

The earlier that something like that is undertaken, the more chance of success, it seems to me, the more chance of the banks getting a good return out of it is there.

Mr. HELMBOLDT. Senator, Mr. Wesson actually answered his own question, because a regulatory change does have to precede a radical receptivity to this sort of idea on the part of the commercial banks, certainly. They cannot accept the sorts of solutions that are being suggested in the current climate, without those solutions having a severe impact on their balance sheets. Therefore their financial results would actually have to be built into each transaction itself.

Mr. MOOSE. But all of that should be open, to be looked at. It should not be put out of bounds simply because it involves the regulatory agencies.

If you want to have a coherent policy on the part of the United States toward Africa, one needs to look at all of these ramifications. A bank that has not gotten anything but occasional interest for some number of years, I am sure in many instances it has been written down, and in some it has been written off, and in other places it has been discounted. So everybody but the debtor government is getting some benefit out of that in some way, and that needs to be looked at.

So some of the kinds of things that are talked about are not really that radical. I put "radical" in quotes simply because there are unthinkable thoughts, especially those who have their capital at risk. But there are other people who have different perspectives, and the committee can afford to think about all of those kinds of things.

The greatest asset of the Western industrialized democracies in the competition we are engaged in, in the developing world are our capital, our markets, and our technology. It is this, as much as anything else at the present time, that is affecting and drawing the attention of and changing the attitudes of many Governments in the developing world to move in some of the directions that have been alluded to today.

Now, we cannot enjoy the benefit of the attraction of those ideas of our system without assuming some of the responsibilities that go along with then. If we do not, at the end of the day, the developing countries are going to see that there was a promise there, that there was a hope, but that they were wrong and the capital really was not there and all there was, was the interest payment. If we do not assume our responsibility, we will have only ourselves to blame at the really radical reaction which will come in those countries if this widow is missed.

Senator KASSEBAUM. Thank you all very much.

I so appreciate your being here and your very interesting comments.

That concludes this hearing.

[Whereupon, at 1:17 p.m., the hearing adjourned, subject to call of the Chair.]

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